



# SOLOMON ISLANDS

November 2018

## 2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE SOLOMON ISLANDS

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2018 Article IV consultation with Solomon Islands, the following documents have been released and are included in this package:

- **Press Release** summarizing the views of the Executive Board as expressed during its October 29, 2018 consideration of the staff report that concluded the Article IV consultation with the Solomon Islands.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on October 29, 2018, following discussions that ended on July 31, 2017, with the officials of the Solomon Islands on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on October 4, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and International Development Association (IDA).
- A **Statement by the Executive Director** for the Solomon Islands.

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Price: \$18.00 per printed copy

**International Monetary Fund**  
**Washington, D.C.**



INTERNATIONAL MONETARY FUND



Press Release No. 18/413  
FOR IMMEDIATE RELEASE  
November 8, 2018

International Monetary Fund  
Washington, D.C. 20431 USA

## **IMF Executive Board Concludes 2018 Article IV Consultation with Solomon Islands**

On October 29, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the 2018 Article IV Consultation with Solomon Islands.<sup>1</sup>

The Solomon Islands economy grew by 3.5 percent in 2017 driven by the logging sector together with higher cash crop yields, fishing revenues, and construction activity. Growth is expected to hold up in 2018 buoyed by infrastructure spending and an acceleration in logging. Inflation is projected at 3.2 percent in 2018 as higher global commodity prices feed through to the CPI. The current account deficit steadied at 4.2 percent of GDP in 2017 and international reserves levels are comfortable.

Monetary conditions are accommodative. Excess liquidity remains high, but credit growth slowed to a 5 percent growth year on year by May 2018.

The overall fiscal deficit widened to 3.8 percent of GDP in 2017 as revenues fell short of expectations, and spending on tertiary scholarships, shipping grants and CDFs remained high. Public debt is picking up from a low level. Risks are on the downside with a weakened fiscal position heightening vulnerability to shocks and natural disasters are an ever-present risk.

### **Executive Board Assessment<sup>2</sup>**

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the recent solid growth performance, contained inflation, and comfortable external reserves. However, Directors noted that the weak fiscal position, a build-up in domestic arrears, and low fiscal buffers limit policy space and leave little room to respond to shocks. Looking ahead, they noted the need to generate new sources of growth. Directors emphasized that a strong commitment to sound

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

<sup>2</sup> 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 summing up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

policies and structural reforms is necessary to maintain macroeconomic stability, address vulnerabilities, and support sustained growth. Achieving sustained growth would also require substantial infrastructure investment.

Directors stressed that securing fiscal sustainability should be a priority. They encouraged the authorities to take action to resolve domestic government arrears and to gradually rebuild fiscal buffers to build resilience, including from natural disasters. Directors underscored the importance of boosting revenues, strengthening tax compliance, and containing spending. In addition, they emphasized that spending priorities need to be better aligned with the National Development Strategy.

Directors encouraged sustained fiscal reform efforts, including advancing public financial management and preparing a Medium-Term Fiscal Strategy to assess the tradeoffs between development spending and building buffers. They also called for greater transparency of the Constituency Development Funds. Directors welcomed the authorities' interest in strengthened tax administration and reform. A medium-term revenue strategy would help to guide policy goals and sequencing.

Directors considered the current monetary policy stance and the basket exchange rate peg regime to be appropriate. A modest increase in the cash reserve requirement would help absorb structural excess liquidity. Directors encouraged periodic reassessment of the level of the exchange rate to ensure that it remains supportive of external stability and economic growth.

Directors commended the authorities' efforts to improve financial inclusion and to link it to resilience building. They highlighted that clearing the backlog of financial legislation would help strengthen the financial sector supervisory and regulatory framework. Directors encouraged the authorities to take steps to ensure the effectiveness and enforcement of the AML/CFT framework. They also emphasized that these reforms, in addition to addressing governance issues in the logging industry, would help sustain correspondent banking relationships.

Directors emphasized that structural reforms aimed at greater private sector involvement are key to supporting growth and generating new sources of growth. They also called for continued efforts to enforce and push ahead with the anti-corruption agenda and highlighted that a strong policy and regulatory environment is important to ensure that the maximum benefits from the mining sector are secured.

## Solomon Islands: Selected Economic Indicators 2014–19

Per capita GDP (2014): US\$1,931

Population (2014): 562,000

Poverty rate (2006): 23 percent

Quota: SDR 20.8 million

Main products and exports: logs

Main export markets: Emerging Asia

	2014	2015	2016	2017	2018	2019	2020
				Est.			Proj.
<b>Growth and Prices</b>	Annual percentage change unless otherwise indicated						
Real GDP	2.3	2.5	3.5	3.5	3.4	2.9	2.8
CPI (period average)	5.2	-0.6	0.5	0.5	2.6	2.6	2.9
CPI (end of period)	4.2	3.5	-2.2	2.1	3.2	3.3	3.6
GDP deflator	2.5	3.1	3.6	2.7	4.2	3.4	3.5
Nominal GDP (in SI\$ millions)	8,646	9,139	9,798	10,420	11,228	11,946	12,705
<b>Central Government Operations</b>	In percent of GDP						
Total revenue and grants	47.3	47.9	43.1	42.7	43.3	43.2	42.7
Revenue	32.8	35.1	31.7	32.5	32.4	32.2	32.0
Grants	14.5	12.9	11.4	10.2	10.9	11.0	10.7
Total expenditure	45.2	48.0	47.0	46.5	46.9	46.5	46.7
excluding grant-funded expenditure	30.7	35.1	35.6	36.4	36.1	35.5	36.0
Recurrent expenditure	32.6	33.7	32.0	31.5	32.6	31.5	31.6
Development expenditure	12.6	14.3	15.0	15.1	14.3	15.0	15.1
Unrecorded expenditure 1/	0.4	0.2	-0.6	-1.6	0.0	0.0	0.0
Overall balance	2.1	0.0	-3.9	-3.8	-3.6	-3.3	-4.0
Foreign financing (net)	-0.5	-0.2	0.3	0.2	2.0	2.6	3.2
Domestic financing (net)	-1.2	0.4	3.0	2.1	1.7	0.7	0.8
Central government debt 1/	11.9	10.1	7.9	9.4	12.1	14.6	17.6
<b>Macrofinancial</b>	Annual percentage change (end of year)						
Credit to private sector	16.4	16.7	12.1	8.0	6.0	5.5	5.0
Broad money	5.6	15.0	13.4	6.7	5.0	4.4	4.4
Reserve money	-10.1	23.5	14.5	7.7	8.8	8.8	8.3
Deposit accounts with commercial banks per 1,000 adults	454.3	487.5	526.2	...	...	...	...
Loan accounts with commercial banks per 1,000 adults	40.1	39.4	31.2				
<b>Balance of payments</b>	In US\$ millions unless otherwise indicated						
Trade balance	-116.7	-93.5	-71.6	-75.5	-114.6	-129.8	-144.2
(percent of GDP)	-9.9	-8.1	-5.8	-5.8	-8.0	-10.4	-10.9
Current account balance	-50.1	-35.2	-48.7	-54.2	-91.7	-125.5	-141.4
(percent of GDP)	-4.3	-3.0	-3.9	-4.2	-6.4	-8.3	-8.8
Foreign direct investment	20.3	27.6	36.0	25.8	31.1	49.1	54.1
(percent of GDP)	1.7	2.4	2.9	2.0	2.2	3.2	3.4
Overall balance	-16.2	53.0	2.2	59.9	-30.9	-32.1	-33.1
Gross official reserves (in US\$ millions, end of period) 2/	514.3	519.6	513.6	571.0	536.5	502.3	468.9
(in months of next year's imports of GNFS)	10.0	10.0	9.2	9.0	7.7	6.8	6.1
Net official reserves (in US\$ millions, end of period)	496.2	505.6	503.5	561.0	530.1	497.9	464.8
(in months of next year's imports of GNFS)	9.6	9.7	9.1	8.9	7.6	6.7	6.0
<b>Exchange Rates</b> (SI\$/US\$, end of period)	7.4	8.1	8.2	7.9	...	...	...
Real effective exchange rate (end of period, 2005 = 100)	144.7	154.3	150.4	147.9	...	...	...
<b>Memorandum Items:</b>							
Cash balance (in SI\$ millions)	880	694	412	343	206	122	20
in months of recurrent spending	5.1	3.6	2.0	1.5	0.8	0.5	0.1
SIG Deposit Account (MEFP Table 2; monitored under the ECF in addition to the cash balance, in SI\$ millions)	140	140	140	140	140	140	140
Broader cash balance (=Cash balance+ SIG Deposit Account; in SI\$ millions)	1,020	834	552	483	346	262	160
in months of total spending 3/	4.6	3.1	1.9	1.5	1.0	0.7	0.4
Public domestic debt, including arrears (in SI\$ millions)	173	43	43	193	318	318	318

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

1/ Includes disbursements under the IMF-supported programs.

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

3/ Total spending is defined as total expenditure, excluding grant-funded expenditure.



# SOLOMON ISLANDS

## STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

October 4, 2018

### KEY ISSUES

**Context.** Solomon Islands has made substantial progress since the Tensions in the early 2000s but faces considerable economic and governance challenges and is highly vulnerable to natural disasters. The logging industry confronts depletion and new sources of growth are needed. Governance challenges are significant, stemming from weak oversight of the resource sectors, a lack of transparency and a need to strengthen public financial management.

**Article IV Consultation.** The consultation focused on restoring fiscal buffers to build resilience, strengthening public financial management, improving governance, implementing structural reforms and investing in new sources of growth to replace logging and to sustain incomes for a growing population. Staff also emphasized the need to clear the backlog of financial sector regulatory reform.

#### **Policy recommendations:**

- Clear government expenditure arrears and rebuild fiscal buffers to enhance resilience to shocks. Once fiscal buffers are restored, adopt an operational fiscal target to guide annual budgets and maintain fiscal discipline.
- Realign spending priorities in line with the National Development Strategy; streamline in areas that have risen sharply in recent years; and improve transparency.
- Advance public financial management and tax reforms to improve spending and revenue efficiency. Strengthening tax compliance and reduce tax arrears.
- Modestly tighten the monetary policy stance by mopping up structural excess liquidity. Maintain the basket exchange rate peg, with annual reviews to keep the currency basket in line with fundamentals.
- Implement structural reforms to encourage greater private sector involvement in supporting sustained growth and generating new growth sectors. Push ahead with the anti-corruption agenda.
- Strengthen financial stability by completing outstanding financial sector reforms and legislation.

Approved By  
**Odd Per Brekk and  
 Yan Sun (SPR)**

Discussions took place in Honiara during July 18–31, 2018. The staff comprised of Ms. Alison Stuart (head), Ms. Kaendera, Mr. Nishizawa (all APD), and Ms. Hunter (Resident Representative, Pacific Islands). Mr. Kikiolo (OED) joined the mission. The PFTAC coordinator, Mr. David Kloeden and staff attended some meetings and followed up on capacity development. Executive Director Mr. Jang (OED) attended concluding meetings. The mission met with Prime Minister Hon. Rick Houenipwela, Central Bank Governor Denton Rarawa, Permanent Secretary Ministry of Finance and Treasury Harry Kuma, and other government officials, donors, the private sector, Transparency Solomon Islands and CSOs. Ms. Zhang and Ms. Ibrahim provided research and editorial assistance for this report.

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## CONTEXT

### 1. **Solomon Islands has made significant gains since the Tensions, in restoring law and order, re-establishing public institutions, and improving human development indicators.**

Macroeconomic and financial stability have been established over the past fourteen years and important structural reforms implemented, including a Public Financial Management Act, a new debt management framework, and a Central Bank Act. IMF-supported programs from 2010–16 were successful in supporting efforts to build policy buffers, macroeconomic management capacity and institutions. However, following the end of the programs, the fiscal position deteriorated sharply, and, although debt is low, fiscal cashflow problems have emerged (Appendix I).

**2. The country faces large economic development and governance challenges.** The economy has a narrow base concentrated on an over-exploited logging sector, is located far from international markets, has a geographically dispersed population, is highly vulnerable to natural disasters and climate change, is facing a large infrastructure gap and capacity constraints and the political situation remains fluid (Figure 1). These challenges weigh on long-term growth. With the logging industry facing depletion, new sources of growth are needed to meet the Sustainable Development Goals (Appendix II).

**3. Governance challenges are significant.** They stem from management of the logging and the newly-emerging mining sectors, a lack of transparency in government spending, including in Constituency Development Funds (CDFs), and weak public financial management. Problems are long-standing and exacerbated by the lack of local services provision and strained capacity. This results in fiscal slippages undermining stability. Growth is impeded by these governance issues, a slow pace of legislative reforms, and land tenure issues. The new government is aiming to tackle the challenges including through an anti-corruption strategy (paragraph 45), and a focus on sustainable forestry and mining policy. But mitigating governance risks will require sustained effort with greater transparency and effective policy implementation.

### 4. **The economy is vulnerable due to fiscal slippage, political fragility and natural disasters.**

- The erosion of fiscal buffers leaves the authorities with little room to respond to exogenous shocks.
- Solomon Islands is ranked the fourth most vulnerable country to natural disasters among the Pacific islands. In any year, there is a 13.5 percent probability of the occurrence of a severe natural disaster.<sup>1</sup>
- There have been episodes of political instability. Fluid political alliances result in frequent changes in government. In November 2017, the Prime Minister was replaced following a vote of no confidence. The new government coalition faces elections in early 2019.

<sup>1</sup> A severe natural disaster is defined as one above the 75<sup>th</sup> percentile of natural disasters across past experience of the Pacific Islands; affecting more than 7.5 percent of the population or inflicting damage/loss of more than 7.1 percent of GDP see *The Economic Impact of Natural Disasters in Pacific Island Countries: Adaptation and Preparedness*, WP 18/108, D. Lee, H. Zhang, and C. Nguyen.

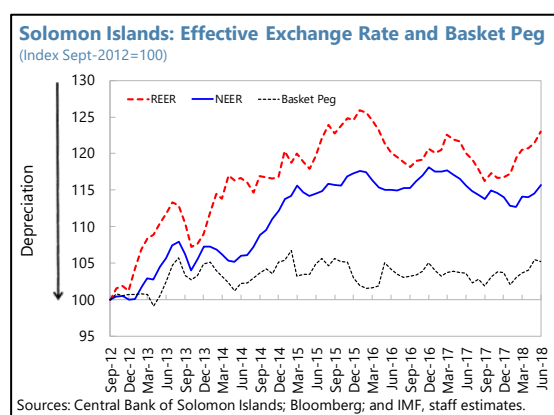
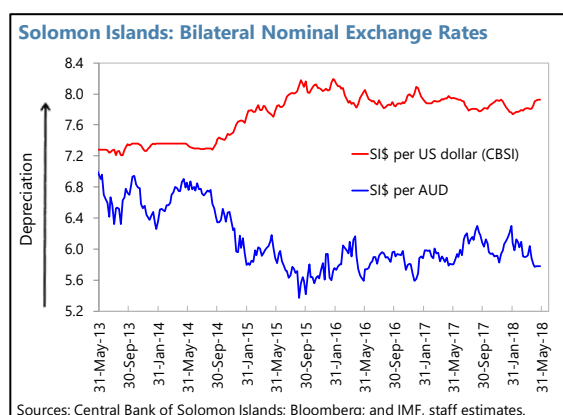


## RECENT DEVELOPMENTS

### *Recent Developments Have Been Encouraging But The Fiscal Position Has Deteriorated.*

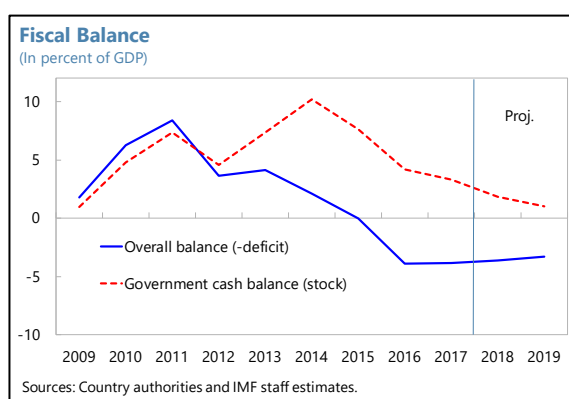
**5. Economic activity has held up well and inflation is contained.** Real growth held up at 3.5 percent in 2017, as logging continued to outperform expectations, coupled with higher cash crop yields, fishing revenues, and construction activity (Figure 2, Table 1). Headline inflation stood at 2.4 percent in June 2018.

**6. The current account deficit remained at around 4.2 percent of GDP in 2017.** Imports outpaced exports reflecting increased infrastructure development, higher import costs and a small nominal effective exchange rate (NEER) depreciation during 2017, weakening the trade balance. The exchange rate moved closely tandem with the US dollar with greater volatility against the Australian dollar. The reserves position remains comfortable, at 8.8 months of import cover in June 2018.



### **7. The fiscal position deteriorated further.**

The deficit reached 3.8 percent of GDP in 2017 as revenues fell short of expectations, and spending on tertiary scholarships, shipping grants and CDFs remained high. The strained fiscal position led to domestic expenditure arrears (1.3 percent of GDP in 2017). The government's broad cash balance declined to 1.5 months of total spending, below the two-month target.<sup>2</sup> Though public debt remains low, it increased to 9.4 percent of GDP in 2017 following the issuance of domestic bonds to the National Provident Fund (NPF) for infrastructure development (Figure 3, Table 2).



<sup>2</sup> The broader cash balance equals the sum of government deposits held at the CBSI and the commercial banks minus unpaid payment orders and unrepresented checks, plus reserves in the government consolidated deposit account (SI\$140mn). The 2016 Article IV recommended monitoring the broader cash balance as a proportion of total spending, with a floor of two months to facilitate day to day cash management.

**8. Monetary conditions are accommodative.** Excess liquidity remains high but credit growth slowed to 5 percent year on year by May 2018—as banks pulled back personal sector lending against a backdrop of rising NPLs. Spreads are high at 10 percent and highlight the need for greater competition among banks.

**9. Financial sector vulnerabilities increased at end 2017.** Net non-performing loans (NPLs) almost doubled in 2017 to 11.5 percent of capital and reserves, as asset quality declined following a period of rapid credit growth and delays in government payments to contractors and service providers disrupted debt service payments. In 2018 Q1 NPLs moved back down and banks curtailed credit.

	2013	2014	2015	2016	2017
<b>Capital Adequacy</b>					
Regulatory Capital to Risk-Weighted Assets	32.4	31.6	31.3	32.3	35.1
Non-performing Loans Net of Provisions to Capital	12.0	8.1	7.3	6.6	11.5
<b>Asset Quality</b>					
Non-performing Loans to Total Gross Loans	7.0	4.7	4.1	3.8	6.1
<b>Earnings and Profitability</b>					
Return on Assets	4.0	3.3	3.4	3.5	3.9
Return on Equity	23.3	20.0	20.1	22.7	23.3
Interest Margin to Gross Income	54.3	56.7	54.7	56.3	55.0
Non-interest Expenses to Gross Income	52.8	51.6	51.9	47.1	47.2
<b>Liquidity</b>					
Liquid Assets to Total Assets (Liquid Asset Ratio)	40.6	38.0	33.5	38.1	38.6
Liquid Assets to Short Term Liabilities	56.5	51.7	46.2	53.3	55.5

Sources: Central Bank of Solomon Islands.

**10. Withdrawal of correspondent banking from a domestic bank poses a potential financial stability risk.** While foreign banks have retained correspondent banking relationships (CBR), environmental and governance concerns surrounding the logging industry have led to difficulties for a domestic bank providing financial services to the industry in finding a replacement CBR. A temporary solution is in place until the end of the year and good progress is being made on a permanent solution to establish a new link (once strengthened screening and transaction monitoring is in place), lessening the immediate vulnerability. However, a recurrence of this problem would pose a downside risk.

## OUTLOOK, RISKS, AND VULNERABILITIES

### *An Uncertain Outlook*

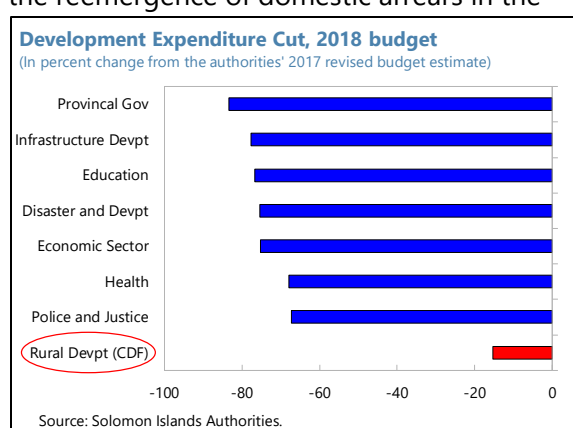
**11. Growth is expected to hold up in 2018 and moderate in 2019.** Donor-supported infrastructure spending is moving ahead following the government's greater engagement with development partners. This together with accelerated logging activity, will underpin growth at around 3.4 percent in 2018. Growth is expected to moderate to 2.9 percent in 2019, due to continuing fiscal problems and a tapering of logging activity. The current account deficit is likely to widen to 6.4 percent of GDP and 8.3 percent of GDP respectively with higher imports for infrastructure (financed by aid and concessional borrowing). Inflation is projected at 3.2 percent in 2018 as higher global commodity prices feed through to the CPI, and then to ease below 3 percent in 2019 and thereafter.

**12. The medium-term outlook is challenging.** On the positive side, large infrastructure projects are going ahead. The Tina hydropower project is expected to come on stream by 2022. The Gold Ridge Mine could restart activity in 2020 (an upside risk to staff's forecast). The undersea

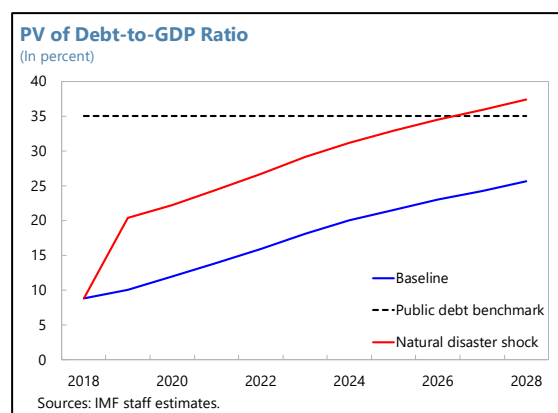
internet cable should boost activity over the longer run. But on the negative side, fiscal challenges may prove hard to manage, logging activity is likely to decline, and the timing of the mining sector expansion is unclear. Staff projects growth at 2.9 percent on average over 2018–23. Inflation is expected to remain moderate at 3.2 over the medium term.

**13. The current account deficit is projected to widen** to 7.5 percent of GDP on average over 2018–23 as upcoming infrastructure projects (including the TRHDP) have a high import content. Non-oil commodity prices remain low, but higher oil prices and transport costs would add to pressure on the current account.

**14. If the fiscal situation is not addressed, cash reserves would be exhausted in 2021.** The government aimed for a balanced budget (excluding external financing) for 2018 to maintain the level of cash balance as of December 2017. However, the reemergence of domestic arrears in the early months of 2018 and other spending pressures, led to a supplementary budget of 2 percent of GDP. Nonetheless, the budget includes a sharp cut in government-funded development expenditures that appears unattainable. Spending on CDFs has been cut only a little for 2018, while development expenditures for most ministries have been cut sharply, leading to some shortages. IMF staff expect the deficit to remain high at 3.6 percent of GDP in 2018 with the cash balance falling to one month of total spending and new domestic arrears of 0.7 percent of GDP. On the current trajectory, the broader cash balance would decline to zero in 2021.



**15. Public debt is expected to rise over the medium term.** The nominal public debt-to-GDP ratio was raised by 5 percentage points to 35 percent of GDP to promote infrastructure development. The Debt Sustainability Analysis (DSA) indicates that the risk of external debt distress remains moderate, in line with the previous assessment, though it illustrates a high vulnerability to shocks. A one-off natural disaster shock, in line with Solomon Islands experience, would significantly add to debt, leading to a breach of the threshold for public debt (see the debt sustainability analysis, tailored shock for natural disasters, Chart, Appendix IV).



**16. Three downside risks cast a shadow over the outlook:**

- **Elections in early 2019** are likely to slow policy reform, lengthening the legislative backlog, and delaying the resolution of fiscal problems.

- **The impact of a possible large natural disaster** on the economy would be intensified as fiscal buffers are almost depleted.
- **Re-emerging difficulties securing correspondent banking links.** Although a solution is in sight for the recent issue, it underscores the concern about dealing with institutions linked to the logging industry. Renewed difficulties would have a major adverse impact on logging exports and the fiscal position—a deterioration compared to the baseline (Appendix V).

**17. The weak fiscal position increases the vulnerability of the economy to shocks.** Fiscal problems could generate an adverse financial sector feedback loop. Continued delays in government payments would drive NPLs up.

<b>Text Table 2. Solomon Islands: Summary Risk Assessment</b>			
<b>High Vulnerability, Risks Weighted to the Downside</b>		<b>Likelihood</b>	<b>Impact</b>
<b>Upside</b>	1. Reopening of Gold Ridge mine and nickel and bauxite projects start up	Medium	High
	2. Positive spillovers from large infrastructure projects	Medium	High
	3. Internet Undersea Cable is highly effective and substantially improves connectivity	High	High
<b>Downside</b>	1. Fiscal policy slippage	High	High
	2. Security risk	Low	High
	3. Weaker-than-expected global growth	Medium/Low	High
	4. Sharp tightening of global financial conditions:	High	Medium
	5. Loss of correspondent bank link	Medium /High	High
	6. Impact of a large natural disaster and over the longer-term more volatile weather conditions due to climate change	High	High

### **Authorities' Views**

**18. The authorities agreed with staff's assessment of the medium-term growth outlook.** They expect logging activity to decline as policies to improve the sustainability of the sector will result in a significant cut in production and new sources of growth are needed over the medium term. In the near term, they expect donor-supported infrastructure projects, such as the undersea cable project and Tina river hydropower project, as well as a reopening of the Gold Ridge mine, and bauxite mining, to provide an offsetting boost to economic growth. Fish catch is also expected to grow.

**19. The authorities are cognizant of the risks to the economy and the need to strengthen the fiscal position to reduce vulnerabilities.** Actions are being taken to contain the fiscal deficit. The authorities are focused on ways to improve the sustainability of the forestry industry. More broadly, the authorities are keen to establish policies to promote development of a healthy mining sector and to promote growth in other sectors, including agriculture and tourism.

## POLICY DISCUSSION: PRIORITIES FOR STABILITY

**20. Fiscal adjustment, tax reform and public financial management strengthening, together with new sources of growth, would promote sustainable development.** Staff emphasized that structural reforms, infrastructure investment, and improved governance would support the business environment and generate growth. It is critical that the governance problems which inflicted the logging sector do not spread to the mining sector. Retaining correspondent banking relationships is essential to preserve foreign exchange inflows and fiscal revenues.

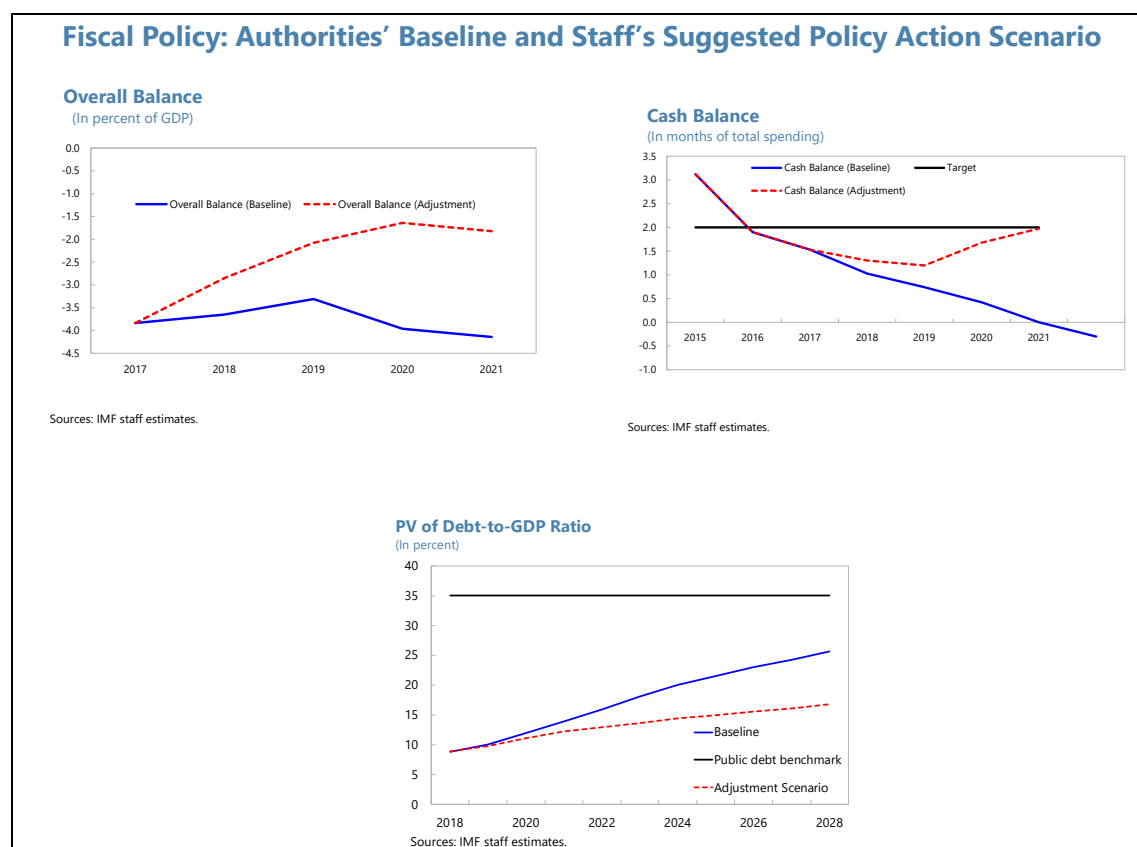
### A. Managing the Fiscal Position

#### Staff's Assessment

**21. Fiscal problems have become acute and remedial action is needed.** Staff recommends policy action to rebuild the cash balance to around 2 months of total spending by 2021 while clearing arrears. A multi-year plan would help get back on track with a cumulative consolidation of 7.3 percent of GDP by 2021 (Table 6).

- **A thorough stocktaking of arrears would clarify the true position.** Claims for 2017 have been paid and contractual commitments for 2018 identified, but it is not clear that all arrears have been eliminated.
- **The 2019 Budget should aim for a cash balance of 1.2 months of total spending.**
  - **Revenues.** Strengthening revenue administration and compliance should continue. The authorities' efforts to reduce tax arrears are yielding good results and will help generate a one-off revenue increase. Steps to streamline and adjust the tax reference prices for logs to bring them into line with world prices should be implemented to reduce the scope for transfer pricing. Similar efforts are needed for bauxite.
  - **Spending.** The 2019 budget offers an opportunity to streamline spending in areas which have increased rapidly in recent years (e.g. CDFs, tertiary scholarships and shipping grants), clear arrears, and better align spending priorities with the National Development Plan. Staff urged the authorities to lower CDF spending, and partially restore critical line-ministry development spending. Expenditure on the 2023 Pacific Games needs to be limited in a prudent manner. While the 2019 budget strategy encouragingly proposes a reallocation of development spending, it also includes a sizeable increase in payroll.
  - **The revenue and expenditure measures should only moderately affect growth.** Fiscal multipliers are likely to be low as the measures aim improving the quality of spending; tackling tax debts and improving efficiency.<sup>3</sup>

<sup>3</sup> The buckets approach (See a Simple Method to Compute Fiscal Multipliers) points to low fiscal multipliers for Solomon Islands, given high openness, weak PFM and potential debt risks.



## Fiscal Policy Goals

**22. Tax reform is an opportunity to generate revenue more efficiently, fairly and equitably.** To yield results, clear guidance is needed on policy goals, sequencing and timing for implementation, and tax administration modernization as well as clientele management (large and small tax payers). This could be achieved in the context of a medium-term revenue strategy. Staff noted that while plans to introduce a VAT law are at an early stage, it would be important to clearly articulate the policy intent for the new VAT as well as other reforms under consideration, build consensus on reform with the business community, and ensure adequate funding and capacity to implement in the Inland Revenue and customs.

**23. Choice of fiscal anchor.** Once the cash balance is restored a fiscal balance target could supplement the debt limit. With debt well below the debt limit of 35 percent of GDP, the limit does not provide an adequate anchor for policy. Staff suggested adding an operational fiscal target of an overall deficit of 1.5 percent of GDP, which would balance containing debt levels with addressing infrastructure needs and consistent with building a fiscal buffer for natural disasters.<sup>4</sup>

**24. Greater transparency of CDFs.** The publication of the audit report on CDFs by the Office of Auditor General is a positive step and it highlighted serious shortcomings. The report recommended increasing citizen participation in the allocation of CDFs, implementing rigorous reporting and third-party oversight of CDF activities, and expanding project management capacity. Implementing

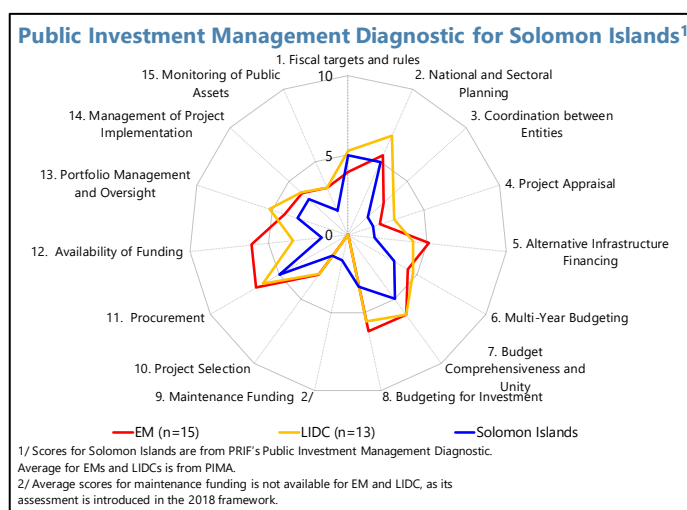
<sup>4</sup> See Box 4 and Selected Issues, Solomon Islands 2017 Article IV Consultation

these recommendations, following the principles of the Commonwealth Parliamentary Association and finalizing the CDF Act would substantially improve the accountability and transparency of CDFs. Champions for reform could be sought to promote progress.

**25. A fiscal buffer to build resilience to natural disasters.** The 2018 budget incorporated a contingency provision (0.7 percent of total spending, excluding grants) for unforeseen expenditures, to cover the costs of moderate but frequent natural disasters. Over the medium term, the authorities could consider a larger contingency, of up to 3 percent of spending given the frequent incidence of disasters.<sup>5</sup> The authorities' plan to set up a Pacific Disaster Contingent Savings Facility with assistance from the ADB is welcome.

**26. Donor coordination and costing of climate change adaptation.** As highlighted in the 2017 Article IV consultation, more complete collection and reporting of programs conducted directly with ministries by development partners would help identify development expenditure gaps, including in disaster risk reduction and contingency planning.

**27. Limited resources and a large infrastructure gap heighten the importance of efficient public investment.** The Pacific Regional Infrastructure Facility (PRIF), *Public Investment Management Diagnostic Report* for Solomon Islands found that Solomon Islands has shortcomings in many aspects of the project management cycle, including project appraisal and selection (Chart, Appendix VI).



**28. Public financial management strengthening should continue.** The Accountant General position has recently been filled and immediate priorities for PFM reform include developing a short-term liquidity forecasting, improving monitoring and bank reconciliation, and curbing the issuance of warrants. The public expenditure and financial accountability roadmap is comprehensive but to make greater progress it will be important to focus on a core set of actions.

### **Authorities' Views**

**29. The fiscal position had deteriorated in the past two years due to an acceleration of spending and measures are being taken to rectify this.** The new government's 2018 Budget and supplementary budget aim to stabilize the position and eliminate domestic arrears. Better-than-expected revenue collection and revenue mobilization will partly help address the gap. Spending pressures remain high, but with limited resources, a cut in development expenditures was unavoidable. CDF spending plays a critical role in rural areas to fill gap

<sup>5</sup> This is in line with the IMF's advice "How to Manage the Fiscal Costs of Natural Disasters" Serhan Cevik and Guohua Hang (<https://www.imf.org/en/Publications/Fiscal-Affairs-Department-How-To-Notes/Issues/2018/06/11/How-to-Manage-the-Fiscal-Costs-of-Natural-Disasters-45941>)



in investment and services not provided by central government or donors. However, a scaling back will be considered in the 2019 Budget. The recently passed anti-corruption bill will increase CDF transparency.

**30. Tax reform will be pursued following the 2019 election and compliance efforts are bearing fruit.** The authorities welcome the IMF staff's willingness to support the design and implementation of tax reform through technical assistance and agree that a medium-term revenue strategy would help with planning. As set out in the 2017 Tax Review, it would be important to make progress on the tax administration Act before reviewing of consumption taxes, income taxes and other taxes.

## B. Monetary Policy and Exchange Rate Management

### Staff's Assessment

**31. The accommodative monetary policy stance is broadly appropriate given low inflation, an uncertain growth outlook, and moderate credit growth.** However, a modest tightening of domestic reserve requirements would help mop up structural excess liquidity in view of emerging price pressures.<sup>6</sup> In line with recent IMF technical assistance, the reserve management framework should be reinforced to help stem CBSI valuation losses and increase CBSI's ability to issue Bokolo bills.<sup>7</sup> Further market development would aid monetary policy implementation and debt management.

**32. The basket exchange rate peg remains an appropriate regime for Solomon Islands.** Given the CBSI's balance sheet constraints, structural excess liquidity and a weak interest rate transmission channel, the basket peg is the most suitable nominal anchor for monetary policy. However, the CBSI could usefully review the composition of the exchange rate basket and the parity of the peg on an annual basis to keep the basket composition in line with underlying developments. Although the Australian dollar (AUD) has a significant weight in the basket since food imports are priced in AUD, in practice the CBSI manages fluctuations much more tightly against the US dollar (with an estimated 90 percent weight). Allowing greater volatility against the U.S. dollar (and less against the AUD) could help stabilize the overall basket and ensure that competitiveness is not unduly eroded when there is a sustained U.S. dollar appreciation. This could also help reduce the volatility of food price inflation.

**33. Staff assesses the external sector position to be moderately weaker than suggested by medium-term fundamentals and desirable policies.** The current account (CA) deficit was moderately weaker than the norm in 2017 by around 1.5 percent of GDP (or an overvaluation of around 4.5 percent) and the gap is likely to widen with higher oil prices, infrastructure spending (Appendix VII), and a contraction in logging activity (paragraph 42). Fiscal consolidation and structural reforms would help to narrow the current account gap over the medium term.

<sup>6</sup> Structural excess liquidity reflects the accumulation of export receipts and unsterilized inflows of donor financing.

<sup>7</sup> The CBSI Act requires net assets to be at or above SI\$50 million but they stood at -SI\$13 million in March 2017.



### Authorities' Views

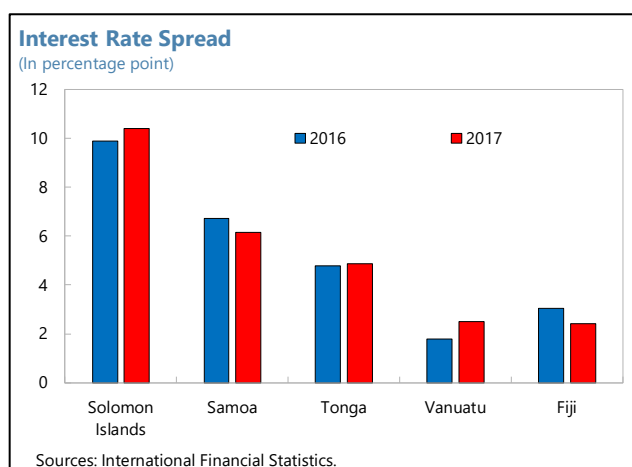
**34. The basket exchange rate peg is working well.** While the current account deficit is expected to widen, this reflects much needed investment in infrastructure and a sizeable proportion of inflows are grants or on concessional terms. The CBSI agreed with the external sector assessment and recognized the need to sustain competitiveness. The authorities are monitoring exchange rate developments and will consider staff's proposal for reviewing the basket on an annual basis. The recommendations of technical assistance on reserve management are being followed up, although some proposals will take time to implement.

**35. The accommodative monetary policy stance is appropriate for current conditions.** Excess reserves are not a major concern as the CBSI does not see them as fueling inflationary pressure. Indeed, recently credit growth has slowed and inflation remains contained. However, the situation is being monitored and excess reserves would be addressed if credit growth or inflationary pressure accelerate markedly.

## C. Financial Stability and Governance

### Staff's Assessment

**36. The financial sector is relatively underdeveloped.** Solomon Islands is among the most underbanked of the small states. The financial sector is inefficient with a small domestic market, a large informal sector, difficulty securing collateral due to communal land ownership and high transaction costs. Interest rate spreads are among the highest in the Pacific (chart and Figure 5).



**37. The CBSI-led National Financial Inclusion Strategy maps out a clear framework for development.** Progress has been made on the take-up of mobile banking and staff encouraged the authorities to continue with the second phase focused on account usage and financial literacy.

**38. Financial sector reforms should continue.** A high priority should be given to finalizing financial legislation including: the new Financial Institutions Act, the Credit Unions Act, and National Provident Fund Act. These acts fill important gaps and would provide the basis for the CBSI to strengthen its supervisory framework. The NPF act would widen international portfolio diversification and help lower excess liquidity.

**39. Progress restoring a CBR link for a domestic bank is welcome.** The problems a bank has faced in terms of finding a new relationship highlights the importance of:

- taking quick remedial actions to address any material gaps in the quality and effectiveness of governance and risk management within the bank;
- bolstering the CBSI's supervisory framework, in line with the IMF TA recommendations, including through the development of prudential standards for governance and establishing a standard for "fit and proper";
- ensuring the effectiveness and enforcement of the AML/CFT framework. The APG AML/CFT mutual evaluation set for later this year is timely;<sup>8</sup>
- contingency planning, should the anticipated solution not be realized or CBR problems re-emerge. Plans could include seeking donor financing to mitigate the shock; considering a temporary relaxation of the export repatriation requirement; and targeted support to communities that lose income;
- and, the bank should also continue to seek additional CBR links in U.S. dollar and other currencies.

The experience demonstrates the need to address the reputational, environmental and governance concerns related to the logging sector.

**40. The plans for a Development Bank (DBSI) should be carefully considered.** Establishing a development bank would be costly, and so staff urged the authorities to explore cheaper alternatives to promote SME financing. Experience, including for Solomon Islands, shows that development banks' performance is mixed with institutions sometimes subject to weak supervision and creating fiscal contingent liabilities. If the DBSI moves ahead, it should be subject to rigorous supervision standards, with supervision by CBSI, and a strong governance structure with independent board members.

#### ***Authorities' Views***

**41. The staff's advice on correspondent banking pressures is welcome and concerns about the legislative delays are noted.** The legislative agenda is full and elections will likely delay progress on some financial sector reforms [although they hoped the Credit Union Act and National Provident Fund Act would be finalized this year]. The authorities are optimistic that a new CBR link will be established by December this year and temporary arrangements are in place until then. Further assistance to follow up on the diagnostic of financial supervision and expedite recommendations with respect to prudential standards on governance and fit and proper would be useful. A final decision on the establishment of the DBSI has not been taken, but the authorities will reflect on staff's views.

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<sup>8</sup> The Solomon Islands will be assessed under the 2012 FATF methodology by APG with the onsite scheduled for October 2018. The 2012 methodology places a greater emphasis on the effectiveness and enforcement of the AML/CFT Framework. The previous 2010 APG/FATF report assessed AML/CFT risks to be very low. But the vulnerabilities within the AML/CFT systems were high given: resource constraints, supervision weaknesses, cash dealers, and a weak compliance culture.

## PRIORITIES TO PROMOTE GROWTH

### A. Encouraging New Growth Areas and Structural Reforms

#### Staff's Assessment

**42. The decline in logging activity and rapid population growth present serious challenges to sustain growth.** Logging currently accounts for more than half of GDP, is the main supplier of foreign exchange and the largest formal-sector employer after the government and a significant provider of government revenues (see Box 1). The pace of logging activity has been unsustainable and quality has dwindled. In line with plans for long-run sustainable logging, the government envisages a sharp contraction in logging activity but such a sharp decline would spill over to the rest of the economy and employment. Staff recommended a more gradual adjustment which seems more likely, given likely challenges enforcing limits in remote areas.

**43. The Medium-Term Development Plan 2016–35 sets the long-term strategy and identifies agriculture, fisheries, forestry, tourism, and mining as possible growth sectors.** The transition to new growth sources is unlikely to be smooth, especially if the sustainable logging policy results in a sharp contraction of activity and as mining is only likely to come on stream in the medium term. The transition should be managed gradually. Investment in agriculture, fisheries and tourism would help broaden income sources. Addressing infrastructure lags relative to peers in sanitation, transport, communications, and energy services, as well as effectively harnessing the potential of the undersea cable, would help facilitate growth and development of the new sectors.

**44. Structural reforms should encourage a greater private sector role in supporting sustained growth.** Narrowing the infrastructure gap requires better transport, communications, and energy services, as well as policies to promote competitiveness and sustainable development of key sectors. Important areas for reform are: enforcement of contracts, procedures for trading across borders, insolvency resolution, access to finance, and property registration are areas for improvement. Tackling challenges posed by customary land-ownership would also be important for development and financial deepening but the issues are deep-rooted in tradition and difficult to address. Long-term leases have been a workable solution in some cases. Granting all community members landowning rights could improve equity and reduce concerns over commercial use. Promoting development of a land registry would help once rights are established.

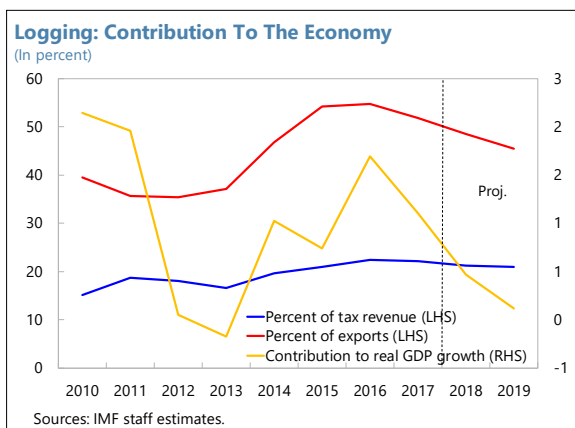
**45. Renewed momentum towards tackling corruption is commendable.**<sup>9</sup> The National Anti-Corruption Strategy, including passage of three important Acts—Anti-corruption (July 2018), Whistleblower and Ombudsman—are positive steps. The Anti-Corruption Act mandates establishing an independent commission against corruption to investigate and prosecute offenders mainly in the public sector but also in the private sector. Research shows that greater transparency and accountability are fundamental to curb corruption. Staff emphasized the role of fiscal transparency,

<sup>9</sup> Solomon Islands is a signatory of the UN Convention Against Corruption but the peer review identifies some gaps in the statutory framework which need to be rectified.

asset declarations for top government officials and politicians, revenue compliance, and a stronger AML/CFT framework. Civil Society can play an important role in pushing effective implementation of the Anti-Corruption Act.

### Box 1. Logging Developments

**Logging has been a major contributor to the Solomon Islands' economy for several decades.** In 2017 the industry accounted for two-thirds of exports of goods and 52 percent of exports of goods and services, 22 percent of total government revenue, and contributed 1.1 percent points to growth; illegal logging activity is also high. Estimates vary about the importance of the sector in employment, but nearly half of the workforce is thought to be directly or indirectly associated with the forestry sector and it is an important source of income for many landowners. Logging activities remained firm during the first five months of 2018 with total round log export volumes, a proxy for log production, increasing by 26 percent year-on-year to 1.309 million cubic meters by June 2018. China continues to be the largest destination for log exports.



**The acceleration of logging over the years is rapidly depleting the resource.** Increased activity reflects the issuance of new licenses, re-entry into formerly logged areas, the approval of tree-felling operations to accommodate palm oil plantations. Earlier forest resource assessments predicted that all commercially viable stocks would be exhausted by 2015 if unsustainable practices continued. An assessment to revisit these earlier estimates is underway. Corruption among logging companies and sectors of society has exacerbated the damage as well as poor enforcement and non-compliance with legislation.

#### Estimate of Foregone Revenue on Logs Exported to China in 2016

	USD/m <sup>3</sup>	Source/Assumptions
Landed CIF price	289.5	UN Comtrade database
-freight	57.9	20% CIF price-estimated
-insurance	5.8	2% of CIF price-estimated
-agent fees	17.4	6% CIF price-estimated
sub total	208.4	
declared fob	100.6	Determined value schedule
Difference	107.8	unaccounted difference between declared and landed
	1256.0	Log exports to China in thousand cubic meters in 2016, Comtrade data
	135.4	Foregone income in US million dollars
	33.9	Estimated foregone revenue, US million dollars
	2.7	foregone revenue as percent of GDP

**The reference price for logs remains well below international market prices, resulting in foregone government revenues.** The government appears to have deferred plans to revise reference prices on a quarterly basis. Between 2016 and 2018 reference prices have been adjusted by 10–15 percent, this is small compared to the substantial gap with world market prices. The delayed adjustment in reference prices has resulted in lost tax revenues, estimated at about 2.7 percent of GDP in 2016. Rough estimates, show that foregone revenues could be as high as 5 percent of GDP for 2017.

### **Authorities' Views**

**46. It is imperative for Solomon Islands to generate new sources of growth over the medium term.** Reform of the logging sector is long overdue but it will be difficult and adopting sustainable practices would result in a sharp contraction in activity, shrinking exports and government revenues. Bridging the transformation from logging to other activity will require careful policy management and support from the Fund and other development partners. On structural reforms, greater emphasis is being placed on creating an effective legislative environment with strong enforcement. The recently passed anti-corruption bill will fortify efforts in curbing corruption.

## **B. Governance of the Logging and Mining Sectors**

### **Staff's Assessment**

**47. Global concerns about the environmental impact of logging in Solomon Islands are long-standing.** Regulatory enforcement is lax, and the industry is largely controlled by foreign companies. Past attempts to reduce uncontrolled logging have been unsuccessful. The CBR withdrawal placed a spotlight on unsustainable logging practices. The formation of the inter-agency committee to guide policies for a sustainable logging sector is welcome. To be successful, enforcement of policies and transparency will be critical, as well as establishing credible forestry management certification, reducing the scope for transfer pricing, and promoting development of well-managed plantations. Clamping down on corruption would enable Solomon Islands to expand its export markets.

**48. Mining is likely to become an increasingly important source of growth over the medium term.** Large deposits of gold, copper, nickel and bauxite have been identified across the country. Rehabilitation of the Gold Ridge mine is the most promising immediate prospect followed by nickel and bauxite. The Gold Ridge mine contains an estimated 9 million tons of gold, with extraction expected to last 15 years. Despite strong interest and intense prospecting, communities and government agencies have little experience working with the mining sector.

**49. Reaping benefits from the mining sector would require a strong regulatory and policy environment.** The National Mining Policy (NMP) was launched in June 2017 and work has begun on legislation, regulatory and oversight capacity. Gaps in agency coordination, adjustments to tax administration, information collection and audit procedures need to be addressed. Staff also recommended that the authorities rejoin and fully implement EITI, with the supporting legislation placed on a fast-track.

**50. A new mining fiscal regime was adopted in July 2014.** The fiscal regime is fundamentally sound and competitive. However, non-tax factors are likely to inhibit foreign investment: lack of skilled labor, regulations, high costs of doing business, and skepticism towards mining operations from landowners and citizens. To effectively implement the regime, capacity should be strengthened in the areas of fiscal compliance, auditing, and monitoring market reference pricing.

**Authorities' Views**

**51. The mining regime would need to be transparent, predictable and even-handed for industry to be viable.** Work is already underway to operationalize the Mining Policy through new regulations and reform of existing legislation. Most of the outstanding tax policy and administrative issues raised by previous Fund TA had been addressed. These should ensure that the mining fiscal regime provides an attractive tax environment while safeguarding government revenues. Assistance to address transfer pricing is required.

**C. Financial Inclusion in Support of Climate Change Adaptation**

**52. Promoting financial inclusion can support climate change adaptation.** The National Financial Inclusion Strategy (NFIS) includes an objective to build financial resilience in households and communities by expanding the formal sector for microinsurance and saving products for informal workers through the National Provident Fund (SINPF). Promoting access to insurance, savings, and credit, can help those who are vulnerable to the effects of climate change. Insurance services spread out risks and reduce losses caused by extreme weather events. Use of weather index-based insurance can help insulate farmers from losses due to weather shocks. Research shows that subsidized insurance can encourage larger investment (but costs would need to be contained). Similarly, savings help consumption smoothing in the event of natural disasters and boost agricultural investment. Access to credit can also boost climate-resilient technology investment in, particularly in the agricultural sector.

**Authorities' Views**

**53. The strategy on financial inclusion is wide-ranging.** A key challenge for the second phase is to encourage greater usage of opened accounts and extend usage of mobile payments. The CBSI is updating the guidance note on mobile money. The authorities are keen to learn from global developments and innovations in financial inclusion. Generating a positive feedback loop between financial inclusion and climate change adaptation was important. Given an underdeveloped private sector, the authorities continue to play a pivotal role in driving financial inclusion through the NFIS to cope with climate-related disasters.

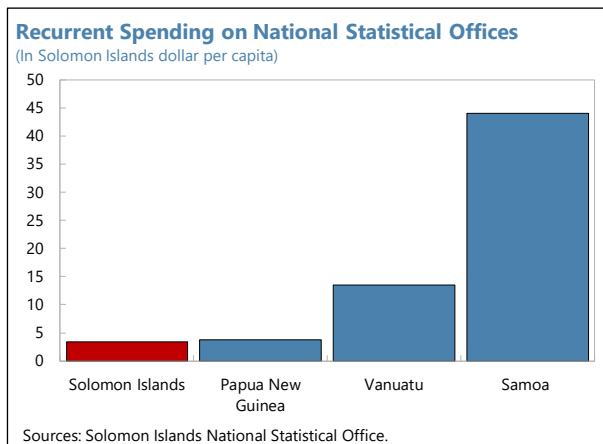
**D. Other Issues**

**54. The authorities expressed interest in continued Fund technical assistance, including in new areas.** The IMF is engaged in assistance on tax policy and revenue administration, public financial management, monetary and foreign exchange operations, banking supervision, and statistics. The authorities expressed interest in TA on a medium-term revenue strategy, supporting implementation of the anti-corruption bill and advice on transfer pricing in the logging and mining sectors.

**55. Staff welcome progress on the National Statistics Development Strategy.**

Substantial improvements in statistics are underway with the revisions to national accounts, the compilation of a national CPI and the first ever agriculture census and labor force survey. Adequate resources should be channeled to the statistics office, this is especially important for the oncoming census.

## STAFF APPRAISAL



**56. Economic activity has been encouraging but the fiscal position has deteriorated.**

Logging outperformed expectations; and cash crops, fishing revenues, and construction activity all supported growth. Headline inflation is contained, although higher oil prices are likely to push inflation up in the second half of the year. International reserves remain comfortable. However, the fiscal position is precarious leaving little room to respond to shocks. Risks to the outlook are mostly on the downside. Fiscal pressures could weigh on growth, natural disasters are an ever-present risk, and a re-emergence of correspondent banking problems would pose a risk. Prudent policies are essential to safeguard stability.

**57. Solomon Islands faces economic development and governance challenges and needs to generate new sources of growth.** With logging activity expected to decline developing new sources of growth is critical. Achieving this will entail substantial infrastructure investment. To create conditions conducive to private sector growth decisive actions will be needed to address long standing governance challenges, together with strong enforcement of anti-corruption measures. A deteriorating fiscal position has limited policy space.

**58. Rebuilding the government cash balance and prioritizing spending would help secure fiscal sustainability and build resilience.** The authorities are strongly encouraged to clear domestic arrears and begin rebuilding the cash balance by boosting revenues and improving compliance, containing spending and realigning priorities consistent with the National Development Strategy. Efforts to improve revenue compliance are making some welcome progress but spending priorities remain to be tackled. Once the cash balance is restored, the cash balance and debt limit should be supplemented by an operational fiscal target to guide annual budgets and maintain discipline.

**59. The authorities should sustain fiscal reform efforts.** Public financial management strengthening should continue. Presenting a Medium-Term Fiscal Strategy would help assess the tradeoffs between development spending and building buffers, including for disaster risk reduction. Greater transparency of the Constituency Development Funds is needed to gain an accurate picture of development spending. Together with improvements to the legal framework, and a stronger AML/CFT framework, this would contribute to anti-corruption efforts. The authorities interest in tax reform is encouraging and would be an opportunity to generate revenue more efficiently, fairly, and equitably. A medium-term revenue strategy could help guide policy goals and sequencing.



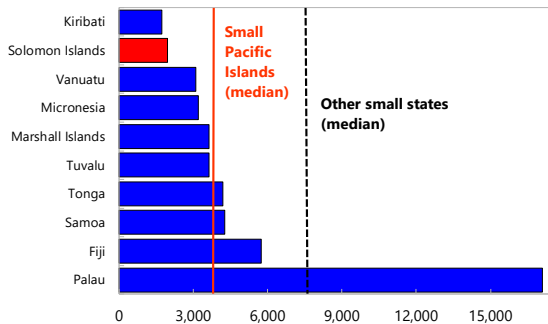
- 60. A modest tightening of monetary settings is called for.** A small increase in domestic reserve requirements would help reduce structural excess liquidity. Improvements to the reserve management framework could help strengthen the central bank's balance sheet and increase the ability to issue Bokolo bills and mop up liquidity more effectively.
- 61. The basket exchange rate peg is appropriate.** The CBSI could usefully review the composition of the exchange rate basket and the parity on an annual basis to keep the basket in line with underlying developments so that competitiveness is not eroded. The external sector position is assessed to be moderately weaker than suggested by medium-term fundamentals. Fiscal consolidation and structural reforms would help to narrow the current account gap over the medium term.
- 62. The transition from logging to new growth areas should be managed gradually in line with capacity while ensuring macro stability.** Mining is likely to become an important source of growth. Reaping benefits from the mining sector requires a strong regulatory and policy environment. Work remains to be completed on legislation, regulation and oversight to create a conducive environment for mining. It is critical that the governance problems which inflicted the logging sector do not spread to the mining sector.
- 63. Structural reforms would support sustained growth.** Areas for reform include the legal and regulatory framework for the business environment, enforcement of contracts, and exploring options for small business finance. Tackling challenges posed by customary land-ownership is important for development and financial deepening. Renewed momentum on tackling corruption is commendable.
- 64. Financial sector reforms should continue.** A high priority should be given to finalizing the backlog of financial legislation. These acts fill gaps and would provide the basis for the CBSI to strengthen its supervisory framework. While progress restoring a correspondent banking relationship is being made, the difficulties highlight the importance of an effective AML/CFT framework, a robust supervisory framework; and the need to tackle governance issues in the logging industry. The financial inclusion strategy and efforts to link it to resilience building are commendable.
- 65. The quality of macroeconomic data could be further improved.** Adequate resources should be channeled to work on compilation and the dissemination of economic data.
- 66. It is proposed that the next Article IV consultation take place on the standard 12-month cycle.**



**Figure 1. Solomon Islands: The Cross-Country Context**

Solomon Islands is one of the poorest small states and faces many challenges...

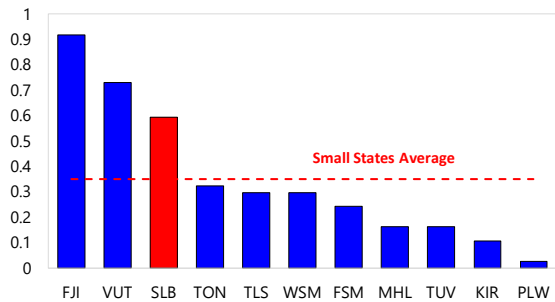
**GDP per Capita, 2017**  
(In U.S. dollars)



Sources: Country authorities and IMF staff calculations.

...including vulnerability to natural disasters...

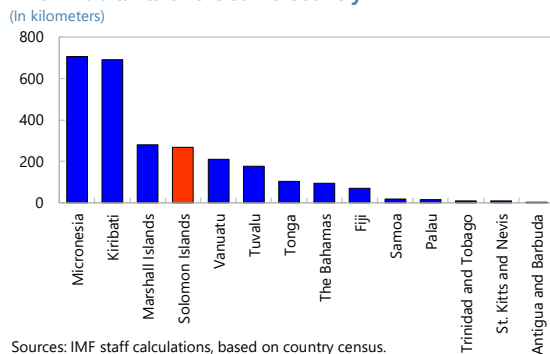
**Pacific Island Countries: Average Number of Natural Disasters per Year (1980-2016)**



Sources: Center for Research on Epidemiology of Disasters, International Disaster Database; and IMF staff estimates.

...geographical dispersion...

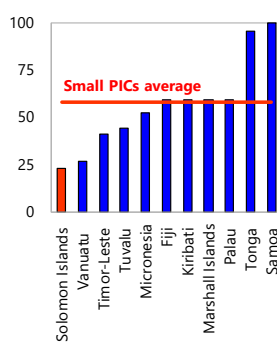
**Geographical Dispersion: Average Sea Distance Between Two Inhabitants of the Same Country**  
(In kilometers)



Sources: IMF staff calculations, based on country census.

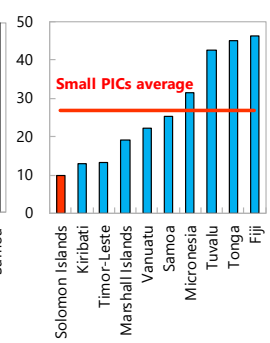
...high infrastructure gaps...

**Access to Electricity**  
(In percent of population)



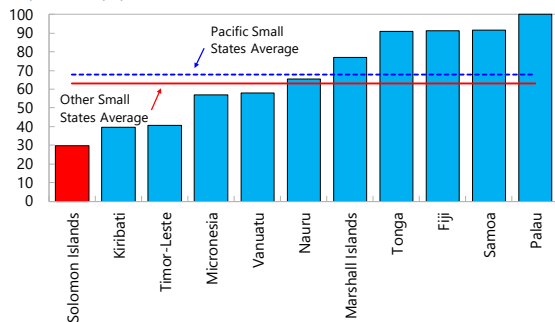
Source: World Bank Group, WDI.

**Internet Users**  
(Per 100 people)



...low sanitation access...

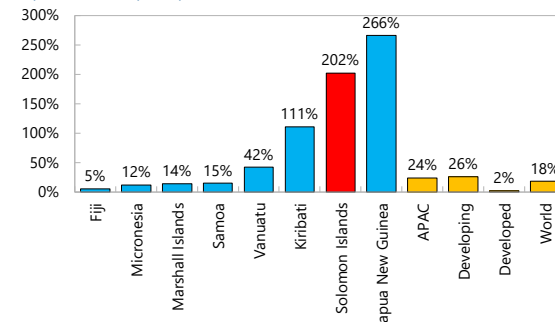
**Sanitation Access, 2015**  
(In percent of population with access)



Sources: World Development Indicators.

...high broadband prices.

**Fixed Broadband Prices**  
(In percent of GNI per capita)



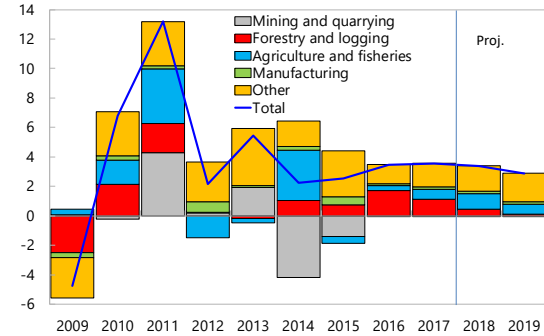
Sources: International Telecommunication Union.

**Figure 2. Solomon Islands: Macroeconomic Developments and Outlook**

*Growth in 2017 was stronger than anticipated, driven by logging, agriculture and fisheries.*

**Sectoral Contributions to Real Growth**

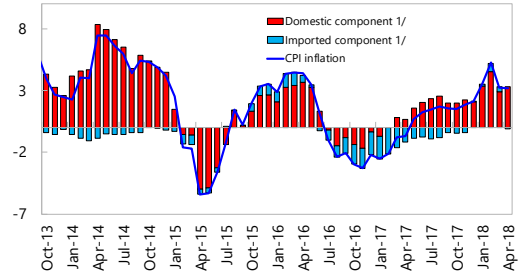
(In percentage points)



*Inflation is relatively contained*

**Contribution to CPI Inflation**

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



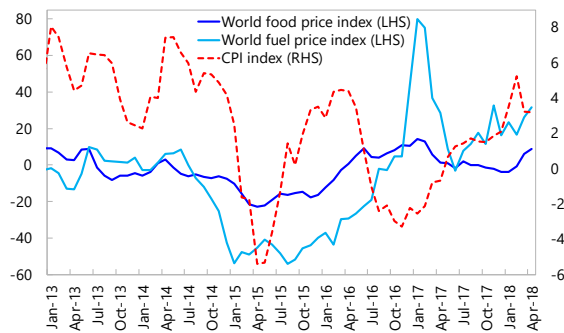
1/ Contribution to CPI inflation (in percentage points).

2/ A negative change means an appreciation of the Solomon Islands dollar against the Australian dollar.

*...but is likely to rise with higher commodity prices*

**CPI Inflation and World Food/Fuel Price Index**

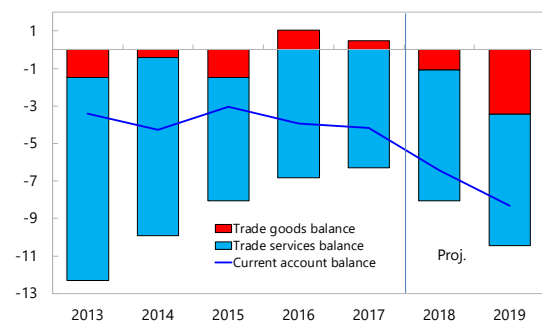
(Year-on-year percent change)



*The current account deficit remained unchanged, due to large repatriation of income*

**Current Account Balance**

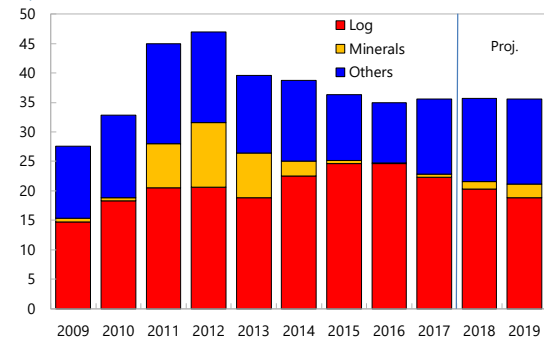
(In percent of GDP)



*Logging exports are increasing again in 2018*

**Total Exports**

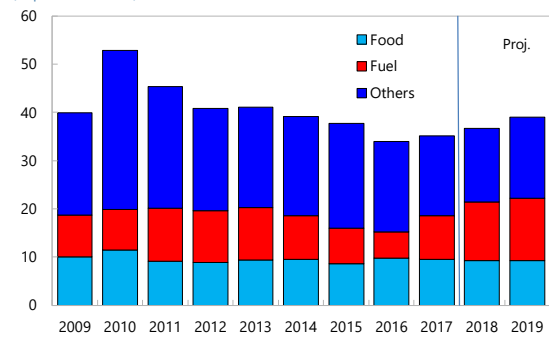
(In percent of GDP)



*Imports of fuel are increasing*

**Total Imports**

(In percent of GDP)



Sources: Country authorities and IMF staff estimates.

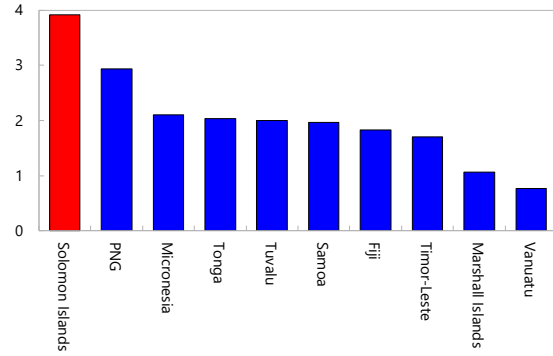
**Figure 3. Solomon Islands: Fiscal indicators**

Solomon Islands' high fiscal revenue volatility...

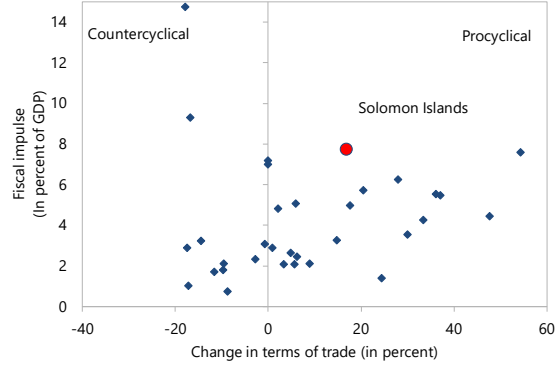
...leads to a procyclical fiscal policy due to a lack of fiscal anchor and weak PFM.

**Volatility of Tax Revenue**

(Standard deviation of tax revenue to GDP ratio, 2005-2017)



**Fiscal Impulse and Terms of Trade, 2005-17**

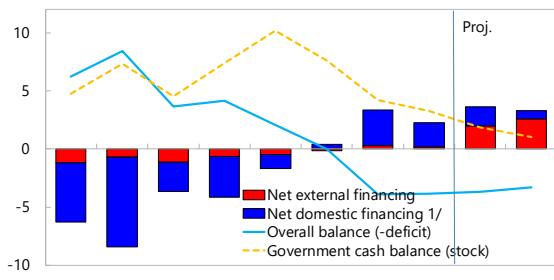


The government's fiscal buffer has shrunk as the fiscal position continues to deteriorate...

...and as public debt rises from a low level to finance large infrastructure projects.

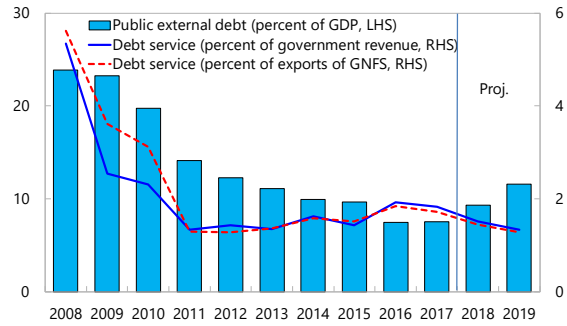
**Fiscal Balance and Financing**

(In percent of GDP)



1/ Includes privatization receipts.

**Public External Debt**

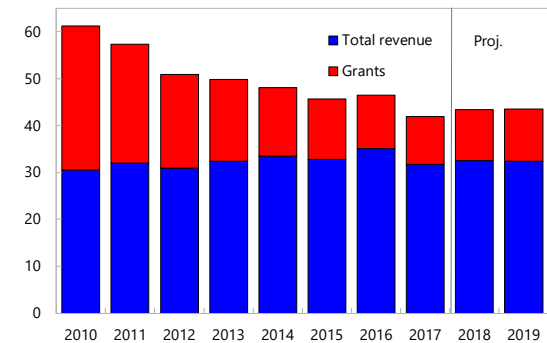


Revenue collection is improving slightly...

...but expenditures are elevated.

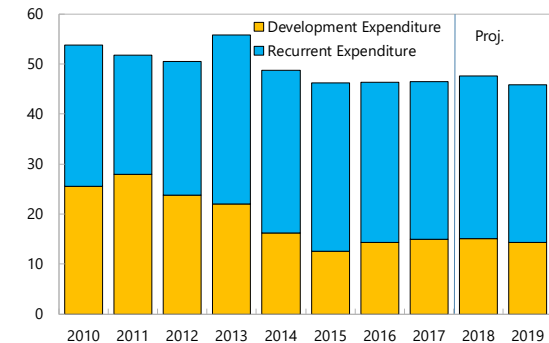
**Government Revenue**

(In percent of GDP)



**Government Expenditure**

(In percent of GDP)

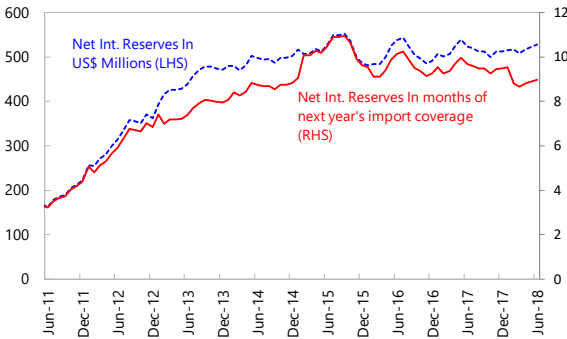


Sources: Country authorities and IMF staff estimates.

**Figure 4. Solomon Islands: Money and Credit Developments**

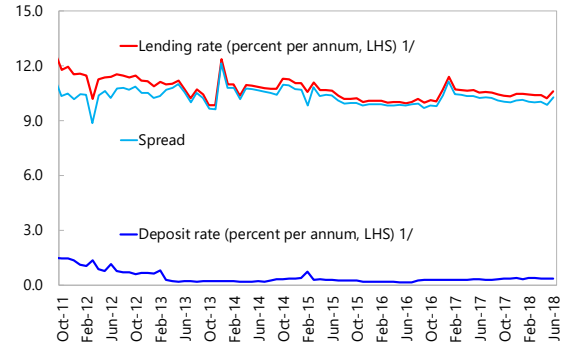
*Reserves remain adequate*

**Net International Reserves**  
(In millions of US\$)



*While lending rates remain high*

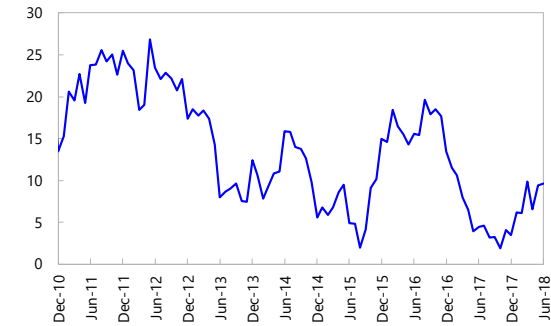
**Lending and Deposit Rates**



*Broad money growth is moderate in line with nominal GDP growth*

**Broad Money**

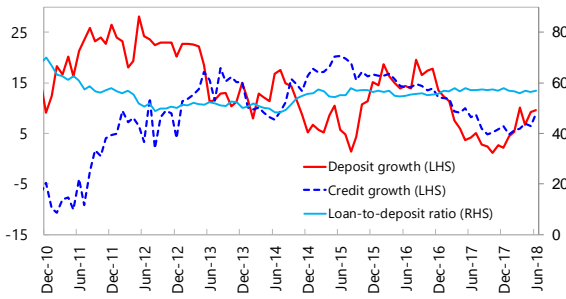
(Year-on-year percent change)



*Credit growth decelerated through to the early part of the year*

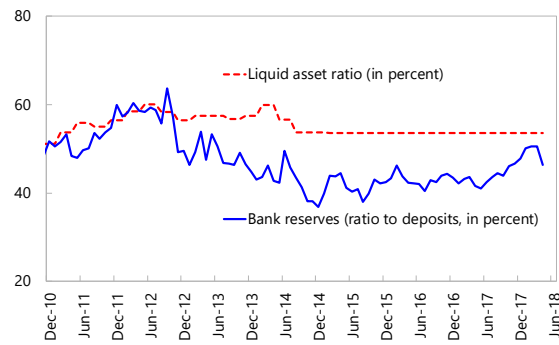
**Deposit and Credit Growth**

(Year-on-year percent change)



*Bank excess reserves are still high*

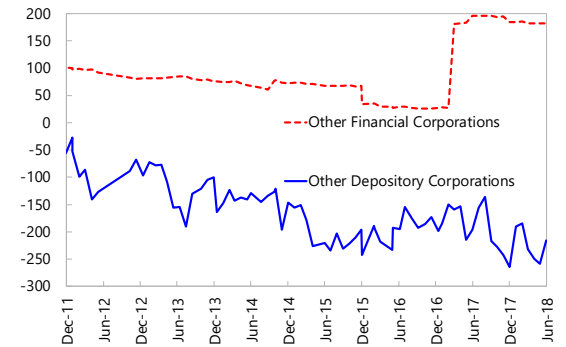
**Liquid Asset Ratio and Bank Reserves**



*Credit to the central government has stabilized after the bond issuance in 2017*

**Net Credit to Central Government**

(In millions of S\$)



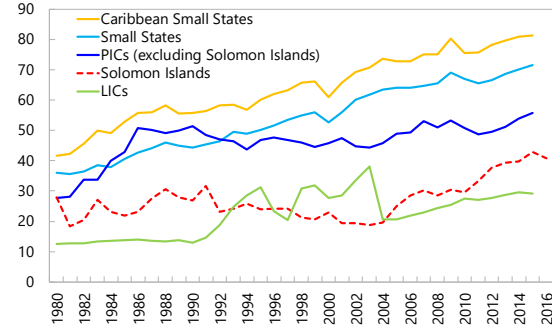
Sources: Central Bank of Solomon Islands and IMF staff estimates.

**Figure 5. Solomon Islands: Financial Access and Inclusion**

*Financial deepening has been increasing but more needs to be done*

**Domestic Bank Deposits to GDP**

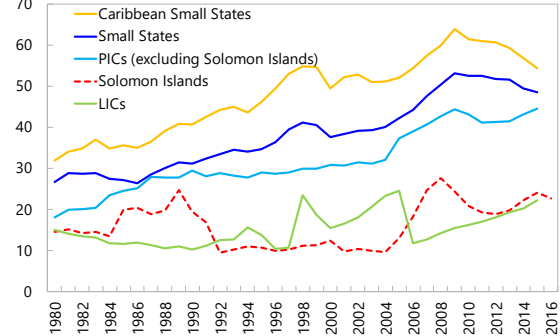
(In percent)



*...and credit to the private sector has been rising*

**Private Credit to GDP**

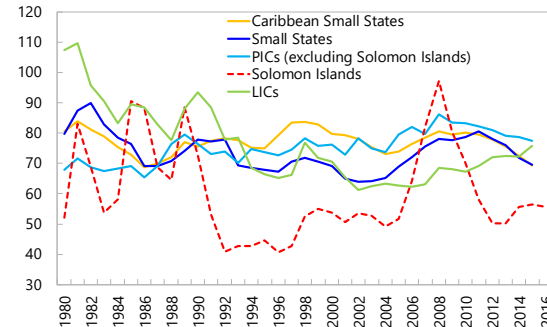
(In percent)



*...although Solomon Islands lags low income peers*

**Private Credit to Deposits**

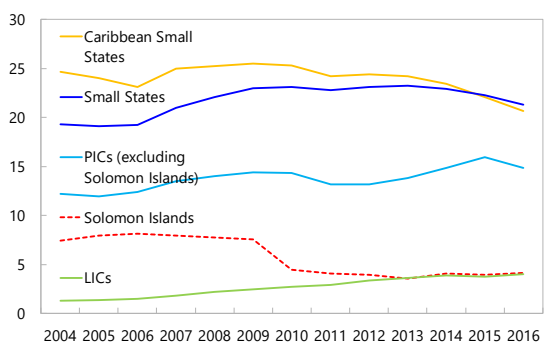
(In percent)



*Geographical dispersion is a major impediment for commercial banking expansion...*

**Number of Branches, Commercial Banks**

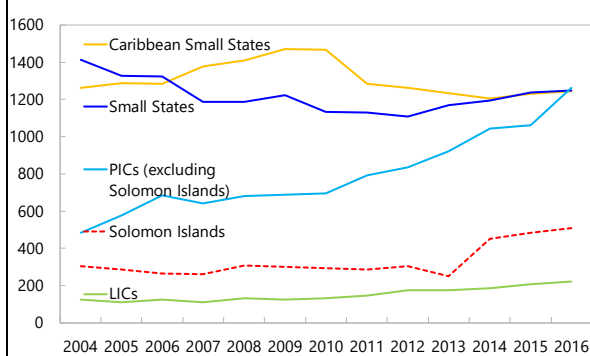
(Per 100,000 adults)



*Resulting in relatively low access to commercial banks...*

**Accounts, Commercial Banks**

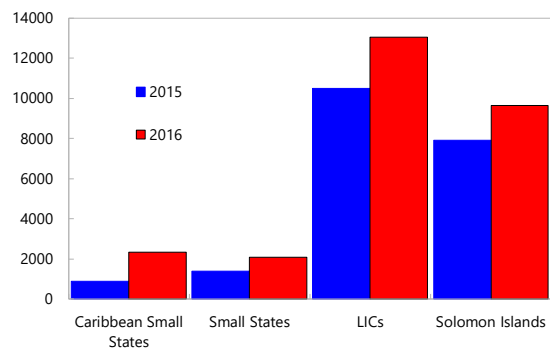
(Per 1,000 adults)



*...although growth in mobile banking could leapfrog conventional banking in financial access.*

**Number of Mobile Money Transactions**

(Per 1,000 adults)

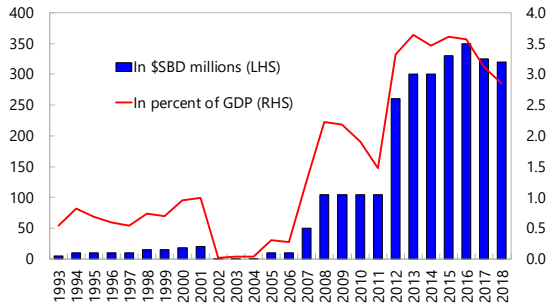


Sources: FomStats 2018 and Financial Access Survey.

**Figure 6. Solomon Islands: Constituency Development Fund (CDF)**

CDF spending has increased over the past ten years....

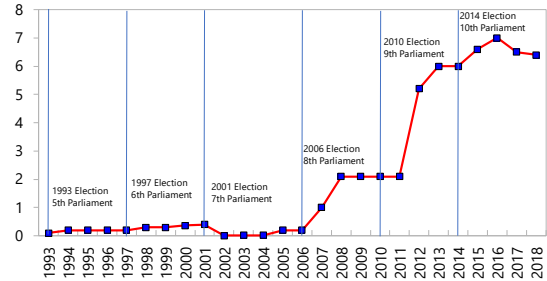
**SIG Budget Allocation For CDF**



Sources: Fraenkel, J 2011, CDF Community Consultation and Assessment Workshop 2017, UNDEF.

Amounts per constituency and MP have risen sharply.

**Budget Allocation Per Constituency**  
(In \$SBD millions)

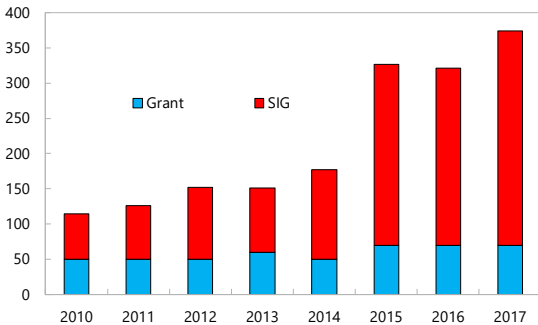


Sources: Fraenkel, J 2011, CDF Community Consultation and Assessment Workshop 2017, UNDEF.

Government-funded CDF has increased sharply since 2014....

**CDF Actuals From 2010-2017**

(In \$SBD millions)

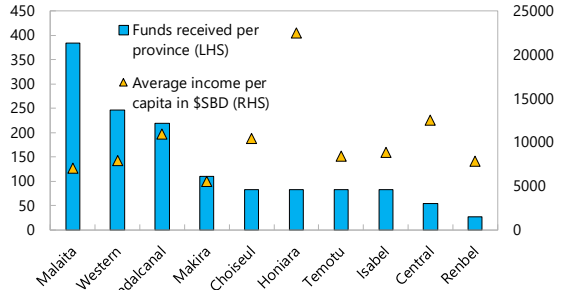


Sources: Solomon Islands Authorities

CDFs are not based on the average income per capita in each province but on the number of MPs....

**Funds Received Per Province From 2010-2017**

(In \$SBD millions)

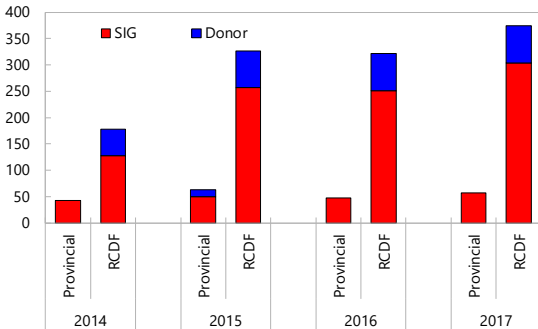


Sources: CDF Community Consultation and Assessment Workshop 2017, UNDEF, Solomon Islands HIES 2012/13.

CDF spending is substantially higher than provincial allocations.

**Spending on Provincial Government and CDF**

(In \$SBD millions)

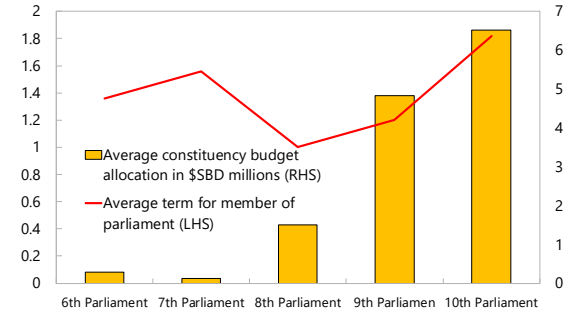


Sources: Solomon Islands Authorities

Average tenure for MPs has risen over time

**Average Term of Parliament Members 1/**

(In unit)



1/ One term is 4 years.  
Sources: IMF staff calculations.

Table 1. Solomon Islands: Selected Economic Indicators 2014–23

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
	Est.				Proj.					
Per capita GDP (2014): US\$1,931	Quota: SDR 20.8 million									
Population (2014): 562,000	Main products and exports: logs									
Poverty rate (2006): 23 percent	Main export markets: Emerging Asia									
<b>GROWTH AND PRICES</b>										
	Annual percentage change unless otherwise indicated									
Real GDP	2.3	2.5	3.5	3.5	3.4	2.9	2.8	2.7	2.7	2.8
CPI (period average)	5.2	-0.6	0.5	0.5	2.7	2.6	2.9	3.2	3.8	4.2
CPI (end of period)	4.2	3.5	-2.2	2.1	3.2	3.3	3.6	3.7	4.0	4.4
GDP deflator	2.5	3.1	3.6	2.7	4.2	3.4	3.5	4.1	3.9	4.6
Nominal GDP (in SI\$ millions)	8,646	9,139	9,798	10,420	11,228	11,946	12,705	13,578	14,492	15,574
<b>CENTRAL GOVERNMENT OPERATIONS</b>										
	In percent of GDP									
Total revenue and grants	47.3	47.9	43.1	42.7	43.3	43.2	42.7	42.2	42.0	41.8
Revenue	32.8	35.1	31.7	32.5	32.4	32.2	32.0	31.7	31.6	31.4
Grants	14.5	12.9	11.4	10.2	10.9	11.0	10.7	10.5	10.4	10.4
Total expenditure	45.2	48.0	47.0	46.5	46.9	46.5	46.7	46.3	46.1	46.2
excluding grant-funded expenditure	30.7	35.1	35.6	36.4	36.1	35.5	36.0	35.8	35.7	35.8
Recurrent expenditure	32.6	33.7	32.0	31.5	32.6	31.5	31.6	31.6	31.7	31.8
Development expenditure	12.6	14.3	15.0	15.1	14.3	15.0	15.1	14.7	14.4	14.4
Unrecorded expenditure 1/	0.4	0.2	-0.6	-1.6	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	2.1	0.0	-3.9	-3.8	-3.6	-3.3	-4.0	-4.1	-4.1	-4.4
Foreign financing (net)	-0.5	-0.2	0.3	0.2	2.0	2.6	3.2	3.0	2.7	2.7
Domestic financing (net)	-1.2	0.4	3.0	2.1	1.7	0.7	0.8	1.2	1.4	1.6
Central government debt 1/	11.9	10.1	7.9	9.4	12.1	14.6	17.6	20.6	23.4	26.1
<b>MACROFINANCIAL</b>										
	Annual percentage change (end of year)									
Credit to private sector	16.4	16.7	12.1	8.0	6.0	5.5	5.0	4.0	4.0	3.5
Broad money	5.6	15.0	13.4	6.7	5.0	4.4	4.4	4.1	5.3	7.3
Reserve money	-10.1	23.5	14.5	7.7	8.8	8.8	8.3	8.8	8.8	9.5
Deposit accounts with commercial banks per 1,000 adults	454.3	487.5	526.2	...	...	...	...	...	...	...
Loan accounts with commercial banks per 1,000 adults	40.1	39.4	31.2							
<b>BALANCE OF PAYMENTS</b>										
	In US\$ millions unless otherwise indicated									
Trade balance	-116.7	-93.5	-71.6	-75.5	-114.6	-157.7	-175.0	-195.3	-214.0	-221.4
(percent of GDP)	-9.9	-8.1	-5.8	-5.8	-8.0	-10.4	-10.9	-11.4	-11.7	-11.2
Current account balance	-50.1	-35.2	-48.7	-54.2	-91.7	-125.5	-141.4	-127.8	-134.5	-133.9
(percent of GDP)	-4.3	-3.0	-3.9	-4.2	-6.4	-8.3	-8.8	-7.4	-7.3	-6.8
Foreign direct investment	20.3	27.6	36.0	25.8	31.1	49.1	54.1	59.3	59.4	61.8
(percent of GDP)	1.7	2.4	2.9	2.0	2.2	3.2	3.4	3.5	3.2	3.1
Overall balance	-16.2	53.0	2.2	59.9	-30.9	-32.1	-33.1	-8.0	-10.8	12.5
Gross official reserves (in US\$ millions, end of period) 2/	514.3	519.6	513.6	571.0	536.5	502.3	468.9	460.6	449.5	461.7
(in months of next year's imports of GNFS)	10.0	10.0	9.2	9.0	7.7	6.8	6.1	5.8	5.2	4.8
Net official reserves (in US\$ millions, end of period)	496.2	505.6	503.5	561.0	530.1	497.9	464.8	456.9	446.0	458.5
(in months of next year's imports of GNFS)	9.6	9.7	9.1	8.9	7.6	6.7	6.0	5.7	5.2	4.7
<b>EXCHANGE RATE (SI\$/US\$, end of period)</b>										
Real effective exchange rate (end of period, 2005 = 100)	144.7	154.3	150.4	147.9	...	...	...	...	...	...
<b>MEMORANDUM ITEMS:</b>										
Cash balance (in SI\$ millions)	880	694	412	343	206	122	20	-140		
in months of recurrent spending	5.1	3.6	2.0	1.5	0.8	0.5	0.1	-0.5		
SIG Deposit Account (In addition to cash balance, in SI\$ millions)	140	140	140	140	140	140	140	140		
Broader cash balance (=Cash balance+ SIG Deposit Account; in SI\$ millions)	1,020	834	552	483	346	262	160	0		
in months of total spending 3/	4.6	3.1	1.9	1.5	1.0	0.7	0.4	0.0		
Public domestic debt, including arrears (in SI\$ millions)	173	43	43	193	318	318	318	318	519	774

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

1/ Includes disbursements under the IMF-supported programs.

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

3/ Total spending is defined as total expenditure, excluding grant-funded expenditure.

**Table 2a. Solomon Islands: Summary of Fiscal Accounts**  
(in millions of Solomon Islands Dollars)

	2014	2015	2016	2017		2018		2019	2020	2021	2022	2023		
	Act.	Act.	Act.	Original Budget	Revised Estimates	Act.	Original Budget	Revised Estimates	Proj.	Proj.	Proj.	Proj.		
(in millions of Solomon Islands dollars)														
Total revenue and grants	4,089	4,381	4,226	4,364	4,315	4,449	4,783	4,953	4,859	5,163	5,429	5,726	6,087	6,508
Total revenue	2,835	3,206	3,108	3,306	3,257	3,391	3,543	3,713	3,639	3,845	4,064	4,305	4,578	4,894
Tax revenue	2,487	2,621	2,578	2,736	2,700	2,838	2,974	3,114	3,055	3,223	3,404	3,599	3,825	4,085
Income and profits	863	991	947	1,004	998	1,028	1,081	1,091	1,082	1,147	1,213	1,290	1,370	1,480
Goods and services	907	855	833	892	875	939	982	1,002	1,001	1,060	1,123	1,196	1,271	1,371
International trade and transactions	717	776	798	840	827	871	911	1,021	972	1,016	1,067	1,113	1,183	1,234
Of which: Tax on logging	487	550	579	579	629	629	577	687	653	663	688	709	754	773
Other revenue	348	585	530	570	557	552	569	599	584	621	661	706	753	810
Grants	1,255	1,175	1,118	1,058	1,058	1,058	1,240	1,240	1,220	1,318	1,365	1,421	1,509	1,614
Development grants	521	434	423	471	471	471	588	588	588	645	653	664	705	754
Recurrent budget grants	734	742	695	587	587	587	653	653	633	673	712	757	804	860
Expenditure	3,908	4,382	4,609	4,742	5,085	4,848	5,005	5,205	5,269	5,558	5,933	6,288	6,677	7,188
Of which: excluding grant-funded expenditure	2,653	3,207	3,491	3,684	4,027	3,790	3,765	3,965	4,049	4,240	4,568	4,867	5,168	5,574
Recurrent expenditure	2,819	3,076	3,137	3,140	3,410	3,280	3,668	3,711	3,659	3,763	4,019	4,291	4,592	4,949
Of which: excluding grant-funded expenditure	2,085	2,335	2,442	2,553	2,823	2,693	3,015	3,059	3,027	3,090	3,307	3,533	3,788	4,089
Compensation of employees	847	1,005	1,009	1,027	1,027	1,063	1,077	1,077	1,123	1,195	1,271	1,358	1,449	1,558
Interest payments	11	40	9	15	15	15	27	27	27	31	35	40	46	63
Other recurrent expenditure	1,960	2,031	2,120	2,098	2,368	2,202	2,400	2,443	2,371	2,538	2,714	2,892	3,097	3,328
Government funded	1,226	1,290	1,425	1,511	1,781	1,615	1,747	1,791	1,738	1,865	2,002	2,135	2,293	2,468
Grant-funded	734	742	695	587	587	587	653	653	633	673	712	757	804	860
Contingency Warrant Provision							26	26						
Resolution of domestic arrears							138	138	138					
Development expenditure	1,089	1,306	1,472	1,602	1,675	1,569	1,337	1,493	1,610	1,795	1,913	1,997	2,085	2,239
Government funded development expenditure	568	872	1,049	1,131	1,204	1,098	749	906	1,022	1,150	1,260	1,333	1,380	1,485
Domestic	568	872	944	1,040	1,113	1,007	462	618	735	782	832	889	949	1,020
External loan	0	0	104	91	91	91	287	287	287	368	429	445	431	465
Grant funded	521	434	423	471	471	471	588	588	588	645	653	664	705	754
Of which: CDFs	178	327	322	325	378	374	320	320	350	292	397	424	453	486
Discrepancy 1/	37	20	-56	0	0	-163	0	0	0	0	0	0	0	0
Current balance 2/	750	871	666	753	434	698	528	654	613	754	757	771	790	805
Primary balance	193	40	-215	-363	-755	-385	-195	-225	-383	-364	-468	-522	-545	-616
Overall balance	181	-1	-383	-378	-770	-400	-222	-252	-410	-395	-503	-562	-590	-679
Total financing	-181	1	383	378	770	400	222	252	410	395	503	562	590	679
Foreign (net)	-43	-15	31	18	18	18	222	221	222	311	402	402	389	424
Disbursements	0	0	104	91	91	91	287	287	287	368	429	445	431	465
Amortization	-43	-16	-73	-73	-73	-73	-65	-65	-65	-57	-27	-43	-43	-41
Domestic (net)	-102	16	352	510	752	219	0	30	187	84	101	160	201	255
Of which : Change in cash balance (+ =decrease)	-272	186	282	210	452	69	0	0	137	84	101	160		
Change in public domestic debt (+ =increase)	-33	-130	0	0	301	150	0	30	125	0	0	0	201	255
Banking system	-98	74	304	360	452	69	0	0	137	84	101	160	0	0
Central bank	-115	170	260	210	452	69	0	0	137	84	101	160	0	0
Commercial banks	17	-96	44	150	0	0	0	0	0	0	0	0	0	0
Nonbank (National Provident Fund and SOEs)	-4	-38	-8	150	300	150	0	30	50	0	0	0	124	128
Memorandum items:														
Nominal GDP (in SI\$ millions)	8,646	9,139	9,798	10,420	10,420	10,420	11,228	11,228	11,228	11,946	12,705	13,578	14,492	15,574
Public domestic debt, including arrears (in SI\$ millions)	173	43	43	43	343	193	193	223	318	318	318	318	519	774
Narrow cash balance (in SI\$ millions) 3/	880	694	412	202	-40	343	343	343	206	122	20	-140		
in months of recurrent spending 4/	5.1	3.6	2.0	1.0	-0.2	1.5	1.4	1.3	0.8	0.5	0.1	-0.5		
SIG Deposit Account (in SI\$ millions)	140	140	140	140	140	140	140	140	140	140	140	140	140	140
Broader cash balance (in SI\$ millions)	1,020	834	552	342	100	483	483	483	346	262	160	0		
in months of total spending 5/	4.6	3.1	1.9	1.1	0.3	1.5	1.5	1.5	1.0	0.7	0.4	0.0		
Accumulated domestic arrears (in SI\$ million)							138		80	80	80	80	157	284
Non-commmodity primary balance 6/ (in SI\$ millions)	-294	-510	-953	-941	-1,383	-1,013	-772	-912	-1,036	-1,028	-1,156	-1,231	-1,299	-1,392

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 unrepresented checks (+ = reduction) and the statistical discrepancy.

2/ Defined as total revenue minus recurrent expenditure, excluding grant-funded recurrent expenditure.

3/ Defined as the sum of government deposits held at the CBSI and the commercial banks minus unpaid payment orders and unrepresented checks.

From 2016 onward, deposits held at the CBSI and the commercial banks have used as a proxy for the narrow cash reserve

4/ Recurrent spending is defined as recurrent expenditure, excluding grant-funded recurrent expenditure.

5/ Broader cash balance = Narrow cash balance + SIG Deposit Account; Total spending is defined as total expenditure, excluding grant-funded expenditure.

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



**Table 2b. Solomon Islands: Summary of Fiscal Accounts**  
(in percent of GDP)

	2014	2015	2016	2017			2018		2019	2020	2021	2022	2023
	Act.	Act.	Act.	Budget	Revised Estimates	Act.	Original Budget	Revised Estimates	Proj.	Proj.	Proj.	Proj.	Proj.
(In percent of GDP)													
Total revenue and grants	47.3	47.9	43.1	41.9	41.4	42.7	42.6	44.1	43.3	43.2	42.7	42.0	41.8
Total revenue	32.8	35.1	31.7	31.7	31.3	32.5	31.6	33.1	32.4	32.2	32.0	31.7	31.4
Tax revenue	28.8	28.7	26.3	26.3	25.9	27.2	26.5	27.7	27.2	27.0	26.8	26.5	26.2
Income and profits	10.0	10.8	9.7	9.6	9.6	9.9	9.6	9.7	9.6	9.6	9.6	9.5	9.5
Goods and services	10.5	9.4	8.5	8.6	8.4	9.0	8.7	8.9	8.9	8.9	8.8	8.8	8.8
International trade and transactions	8.3	8.5	8.1	8.1	7.9	8.4	8.1	9.1	8.7	8.5	8.4	8.2	7.9
Of which: Tax on logging	5.6	6.0	5.9	5.6	6.0	6.0	5.1	6.1	5.8	5.6	5.4	5.2	5.0
Other revenue	4.0	6.4	5.4	5.5	5.3	5.3	5.1	5.3	5.2	5.2	5.2	5.2	5.2
Grants	14.5	12.9	11.4	10.2	10.2	10.2	11.0	11.0	10.9	11.0	10.7	10.5	10.4
Development grants	6.0	4.7	4.3	4.5	4.5	4.5	5.2	5.2	5.2	5.4	5.1	4.9	4.8
Recurrent budget grants	8.5	8.1	7.1	5.6	5.6	5.6	5.8	5.8	5.6	5.6	5.6	5.6	5.5
Expenditure	45.2	48.0	47.0	45.5	48.8	46.5	44.6	46.4	46.9	46.5	46.7	46.3	46.2
Of which: excluding grant-funded expenditure	30.7	35.1	35.6	35.3	38.6	36.4	33.5	35.3	36.1	35.5	36.0	35.8	35.8
Recurrent expenditure	32.6	33.7	32.0	30.1	32.7	31.5	32.7	33.1	32.6	31.5	31.6	31.6	31.8
Of which: excluding grant-funded expenditure	24.1	25.5	24.9	24.5	27.1	25.8	26.9	27.2	27.0	25.9	26.0	26.0	26.3
Compensation of employees	9.8	11.0	10.3	9.9	9.9	10.2	9.6	9.6	10.0	10.0	10.0	10.0	10.0
Interest payments	0.1	0.4	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.3	0.3	0.3	0.4
Other recurrent expenditure	22.7	22.2	21.6	20.1	22.7	21.1	21.4	21.8	21.1	21.2	21.4	21.3	21.4
Government funded	14.2	14.1	14.5	14.5	17.1	15.5	15.6	15.9	15.5	15.6	15.8	15.7	15.8
Grant funded	8.5	8.1	7.1	5.6	5.6	5.6	5.8	5.8	5.6	5.6	5.6	5.6	5.5
Contingency Warrant Provision							0.2	0.2					
Resolution of domestic arrears							1.2	1.2	1.2				
Development expenditure	12.6	14.3	15.0	15.4	16.1	15.1	11.9	13.3	14.3	15.0	15.1	14.7	14.4
Government funded	6.6	9.5	10.7	10.9	11.6	10.5	6.7	8.1	9.1	9.6	9.9	9.8	9.5
Domestic	6.6	9.5	9.6	10.0	10.7	9.7	4.1	5.5	6.5	6.5	6.5	6.5	6.5
External loan	0.0	0.0	1.1	0.9	0.9	0.9	2.6	2.6	2.6	3.1	3.4	3.3	3.0
Grant funded	6.0	4.7	4.3	4.5	4.5	4.5	5.2	5.2	5.2	5.4	5.1	4.9	4.8
Of which: CDFs	2.1	3.6	3.3	3.1	3.6	3.6	2.8	2.8	3.1	2.4	3.1	3.1	3.1
Discrepancy 1/	0.4	0.2	-0.6	0.0	0.0	-1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current balance 2/	8.7	9.5	6.8	7.2	4.2	6.7	4.7	5.8	5.5	6.3	6.0	5.7	5.2
Primary balance	2.2	0.4	-2.2	-3.5	-7.2	-3.7	-1.7	-2.0	-3.4	-3.1	-3.7	-3.8	-4.0
Overall balance	2.1	0.0	-3.9	-3.6	-7.4	-3.8	-2.0	-2.2	-3.6	-3.3	-4.0	-4.1	-4.4
Total financing	-2.1	0.0	3.9	3.6	7.4	3.8	2.0	2.2	3.6	3.3	4.0	4.1	4.4
Foreign (net)	-0.5	-0.2	0.3	0.2	0.2	0.2	2.0	2.0	2.0	2.6	3.2	3.0	2.7
Disbursements	0.0	0.0	1.1	0.9	0.9	0.9	2.6	2.6	2.6	3.1	3.4	3.3	3.0
Amortization (accrual)	-0.5	-0.2	-0.7	-0.7	-0.7	-0.7	-0.6	-0.6	-0.6	-0.5	-0.2	-0.3	-0.3
Domestic (net)	-1.2	0.2	3.6	4.9	7.2	2.1	0.0	0.3	1.7	0.7	0.8	1.2	1.6
Of which : Change in cash balance (+ = decrease)	-3.1	2.0	2.9	2.0	4.3	0.7	0.0	0.0	1.2	0.7			
Change in public domestic debt (+ = increase)	-0.4	-1.4	0.0	0.0	2.9	1.4	0.0	0.3	1.1	0.0	0.0	1.4	1.6
Banking system	-1.1	0.8	3.1	3.5	4.3	0.7	0.0	0.0	1.2	0.7	0.8	1.2	0.0
Central bank	-1.3	1.9	2.7	2.0	4.3	0.7	0.0	0.0	1.2	0.7	0.8	1.2	0.0
Commercial banks	0.2	-1.1	0.5	1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nonbank (National Provident Fund and SOEs)	0.0	-0.4	-0.1	1.4	2.9	1.4	0.0	0.3	0.4	0.0	0.0	0.0	0.8
Memorandum items:													
Accumulated domestic arrears (In percent of GDP)						1.3			0.7	0.7	0.6	0.6	1.1
Public domestic debt, including arrears (In percent of GDP)	2.0	0.5	0.4	0.4	3.3	1.8	1.7	2.0	2.8	2.7	2.5	2.3	3.6
Non-commodity primary balance (In percent of GDP)	-3.4	-5.6	-9.7	-9.0	-13.3	-9.7	-6.9	-8.1	-9.2	-8.6	-9.1	-9.1	-8.9

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 unrepresented checks (+ = reduction) and the statistical discrepancy.

2/ Defined as total revenue minus recurrent expenditure, excluding grant-funded recurrent expenditure.

3/ Defined as nonmineral nonlogging revenue (excludes grants) minus government-funded spending excluding interest payments.

Table 3. Solomon Islands: Balance of Payments, 2014–23<sup>1</sup>

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
							Proj.			
	(In millions of U.S. dollars)									
Current account balance	-50.1	-35.2	-48.7	-54.2	-91.7	-125.5	-141.4	-127.8	-134.5	-133.9
Trade balance for goods	-4.9	-17.2	12.8	6.4	-15.2	-51.8	-65.6	-73.5	-84.3	-83.5
Exports	455.2	420.3	432.1	462.0	507.7	537.0	562.5	567.3	577.3	632.5
Imports	-460.1	-437.5	-419.4	-455.6	-522.9	-588.8	-628.1	-640.8	-661.6	-716.0
Trade balance for services	-111.8	-76.3	-84.4	-81.9	-99.4	-105.9	-109.4	-121.9	-129.7	-137.9
Exports	111.8	106.4	122.7	129.5	137.4	144.5	151.9	159.7	167.5	176.0
Imports	-223.6	-182.7	-207.2	-211.4	-236.8	-250.4	-261.3	-281.6	-297.2	-313.9
Income balance	-35.7	-24.2	-41.6	-34.0	-46.8	-48.6	-55.3	-34.9	-34.6	-44.8
Current transfers balance	102.3	82.4	64.5	55.3	69.6	80.8	89.0	102.4	114.1	132.3
<i>Of which</i> : Official transfers, net	86.6	78.2	80.8	95.7	110.6	119.2	124.7	135.5	144.4	159.8
Capital and financial account balance	62.3	88.6	93.4	63.2	80.8	113.4	128.3	139.8	143.7	146.4
Capital account balance	70.6	55.2	53.3	50.3	37.3	40.8	41.3	37.8	40.1	38.2
Direct investment balance	20.3	27.6	36.0	25.8	31.1	49.1	54.1	59.3	59.4	61.8
Portfolio investment balance	0.4	-0.7	-1.7	-1.7	0.0	0.0	0.0	0.0	0.0	0.0
Other investment balance	-29.0	6.5	5.8	-11.2	12.4	23.5	32.9	42.8	44.1	46.5
Assets	-17.1	16.2	-7.5	-6.7	-10.3	-9.2	-5.6	-7.7	-7.7	-7.6
of which, amortization of official loans	-7.7	-6.8	-9.2	-9.0	-8.2	-7.2	-3.4	-5.4	-5.4	-5.2
Liabilities	-12.0	-9.7	13.3	-4.5	22.7	32.7	38.5	50.5	51.8	54.1
of which, disbursement of official loans (incl. SDR)	0.4	0.2	13.1	11.3	36.5	46.5	54.2	56.2	54.6	58.9
Errors and omissions	-28.5	-0.3	-42.5	50.8	-20.0	-20.0	-20.0	-20.0	-20.0	0.0
Overall balance	-16.2	53.0	2.2	59.9	-30.9	-32.1	-33.1	-8.0	-10.8	12.5
Financing	15.1	-54.3	-5.2	-60.0	30.9	32.1	33.1	8.0	10.8	-12.5
Change in gross reserves (- = increase)	16.2	-53.0	-2.2	-57.0	34.5	34.2	33.3	8.3	11.2	-12.2
IMF	-1.1	-1.2	-3.1	-3.0	-3.5	-2.1	-0.2	-0.3	-0.4	-0.3
	(In percent of GDP, unless otherwise indicated)									
Current account	-4.3	-3.0	-3.9	-4.2	-6.4	-8.3	-8.8	-7.4	-7.3	-6.8
Trade balance for goods	-0.4	-1.5	1.0	0.5	-1.1	-3.4	-4.1	-4.3	-4.6	-4.2
Exports	38.8	36.3	35.0	35.6	35.6	35.5	35.0	33.0	31.5	32.1
Imports	39.2	37.8	34.0	35.1	36.7	39.0	39.1	37.3	36.1	36.3
<i>Of which</i> : Official transfers net	7.4	6.8	6.5	7.4	7.8	7.9	7.8	7.9	7.9	8.1
Capital account balance	6.0	4.8	4.3	3.9	2.6	2.7	2.6	2.2	2.2	1.9
Direct investment balance	1.7	2.4	2.9	2.0	2.2	3.2	3.4	3.5	3.2	3.1
<i>Of which</i> : Inward FDI <sup>2/</sup>	1.8	2.8	3.0	1.9	2.1	3.2	3.3	3.4	3.2	3.1
Other investment balance	-2.5	0.6	0.5	-0.9	0.9	1.6	2.0	2.5	2.4	2.4
Memorandum items										
Net international reserves (in US\$ million)	496	506	503	561	530	498	465	457	446	459
In months of next year's GNFS	9.6	9.7	9.1	8.9	7.6	6.7	6.0	5.7	5.2	4.7
Gross official foreign reserves (in US\$ million) <sup>3/</sup>	514	520	514	571	537	502	469	461	449	462
In months of next year's imports of GNFS	10.0	10.0	9.2	9.0	7.7	6.8	6.1	5.8	5.2	4.8
Gross external public debt	9.9	9.7	7.5	7.6	9.3	11.6	14.3	16.6	18.2	19.7
Disbursement of concessional borrowing (in US\$ millions)	0.4	0.2	13.1	11.3	36.5	46.5	54.2	56.2	54.6	58.9
External public debt service (in percent of exports of GNFS)	1.6	1.5	1.8	1.7	1.4	1.3	0.8	1.1	1.2	1.1

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/ FDI numbers have been revised down as a result of changes to ensure the correct treatment of net losses under reinvested earnings, in line with

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

**Table 4. Solomon Islands: Summary Accounts of the Banking System, 2014–23<sup>1</sup>**

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
										Proj.
	(In millions of Solomon Islands dollars, end of period)									
<b>Central Bank of Solomon Islands (CBSI)</b>										
Net foreign assets (NFA)	3,540	3,960	4,018	4,304	4,056	3,786	3,522	3,456	3,368	3,465
Net international reserves (NIR)	3,651	4,077	4,127	4,411	4,163	3,893	3,629	3,563	3,475	3,571
Other NFA	-111	-117	-109	-107	-107	-107	-107	-107	-107	-107
Net domestic assets (NDA)	-1,708	-1,698	-1,429	-1,135	-802	-384	52	432	864	1,169
Net claims on central government	-1,280	-1,110	-850	-780	-643	-559	-457	-297	-96	159
Claims	69	5	5	5	5	5	5	5	5	5
Deposits	1,349	1,115	855	786	648	564	463	303	101	-154
Other items (net)	136	149	134	140	155	155	155	155	155	155
Reserve money	1,832	2,262	2,589	2,789	3,035	3,302	3,574	3,889	4,232	4,633
Currency in circulation	658	740	828	881	1,009	1,074	1,142	1,221	1,303	1,400
Bank deposits	1,165	1,511	1,748	1,894	2,010	2,211	2,415	2,649	2,909	3,212
Other deposits	9	11	13	14	16	17	18	19	20	22
<b>Other depository corporations</b>										
NFA of commercial banks	287	169	155	134	159	180	185	190	195	200
Assets	365	281	305	283	308	329	334	339	344	350
Liabilities	77	112	150	149	149	149	149	149	149	149
NDA of commercial banks	1,516	1,750	1,999	1,756	1,897	1,965	2,031	1,949	1,921	1,977
Net claims on central government	-146	-243	-198	-154	-154	-154	-154	-154	-154	-154
Claims	44	15	19	19	19	19	19	19	19	19
Deposits	190	257	217	173	173	173	173	173	173	173
Claims on the private sector	1,697	1,981	2,221	2,399	2,543	2,683	2,817	2,929	3,047	3,153
Other items (net)	-35	12	-24	-488	-491	-564	-632	-826	-972	-1,022
Reserves and vault cash	1,248	1,596	1,834	1,999	2,129	2,338	2,550	2,794	3,063	3,378
Deposits	3,051	3,515	3,988	3,889	4,185	4,483	4,766	4,933	5,179	5,555
<b>Depository corporations survey</b>										
NFA of the banking system	3,827	4,129	4,173	4,438	4,215	3,966	3,707	3,647	3,563	3,665
Central bank	3,540	3,960	4,018	4,304	4,056	3,786	3,522	3,456	3,368	3,465
Other depository corporations	287	169	155	134	159	180	185	190	195	200
NDA of the banking system	-192	52	570	621	1,096	1,581	2,083	2,381	2,784	3,146
Net claims on central government	-1,426	-1,352	-1,048	-935	-797	-713	-612	-451	-250	5
Claims on the private sector 2/	1,703	1,988	2,229	2,406	2,550	2,690	2,824	2,937	3,054	3,161
Other items (net)	-469	-584	-611	-851	-657	-397	-130	-105	-20	-20
Broad money (M3)	3,635	4,181	4,743	5,059	5,311	5,547	5,790	6,028	6,348	6,811
M1	2,653	3,272	3,521	3,729	3,984	4,230	4,485	4,737	5,056	5,495
Currency outside banks	575	655	742	776	890	947	1,007	1,076	1,148	1,234
Demand deposits	2,078	2,617	2,779	2,952	3,094	3,284	3,478	3,661	3,908	4,260
Savings and time deposits	982	908	1,221	1,330	1,327	1,316	1,305	1,291	1,292	1,316
	(Annual percentage change, unless otherwise indicated)									
Reserve money	-10.1	23.5	14.5	7.7	8.8	8.8	8.3	8.8	8.8	9.5
Credit to the private sector	16.4	16.7	12.1	8.0	6.0	5.5	5.0	4.0	4.0	3.5
Broad money	5.6	15.0	13.4	6.7	5.0	4.4	4.4	4.1	5.3	7.3
<b>Memorandum items:</b>										
Money multiplier (level)	2.0	1.8	1.8	1.9	1.8	1.7	1.6	1.6	1.5	1.5
Loan-to-deposit ratio (in percent)	55.6	56.4	55.7	61.7	60.8	59.8	59.1	59.4	58.8	56.8
Interest rates (percent per annum)										
Deposit rate 3/	0.2	0.3	0.3	...	...	...	...	...	...	...
Lending rate 3/	10.9	10.5	10.1	...	...	...	...	...	...	...
NCG of financial corporations	-1,354	-1,319	-1,022	-759	-572	-488	-386	-226	-25	230
91-day treasury bill rate	0.3	0.5	0.5	...	...	...	...	...	...	...

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

1/ Based on actual and projected exchange rates.

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

3/ Weighted average of different maturities, period average.

Table 5. Solomon Islands: Indicators of Capacity to Repay the Fund, 2018–27

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
	Proj.									
Fund obligations based on existing credit (in SDR millions)										
Principal	2.4	1.46	0.13	0.19	0.21	0.16	0.13	0.07	0.03	0.00
Charges and interest	0.08	0.09	0.09	0.09	0.09	0.09	0.09	0.09	0.09	0.09
In millions of SDRs	2.48	1.55	0.22	0.28	0.3	0.25	0.22	0.16	0.12	0.09
In millions of US\$	3.49	2.18	0.31	0.39	0.42	0.35	0.31	0.23	0.17	0.13
In percent of gross international reserves	0.65	0.43	0.07	0.09	0.09	0.08	0.07	0.05	0.04	0.03
In percent of exports of goods and services	0.54	0.32	0.04	0.05	0.06	0.04	0.03	0.02	0.02	0.01
In percent of debt service	37.4	24.9	5.7	4.8	4.8	3.8	2.8	1.7	1.1	0.8
In percent of GDP	0.25	0.14	0.02	0.02	0.02	0.02	0.01	0.01	0.01	0.00
In percent of quota	11.9	7.5	1.1	1.3	1.4	1.2	1.1	0.8	0.6	0.4
Outstanding Fund credit										
In millions of SDRs	2.40	0.94	0.80	0.61	0.40	0.24	0.10	0.03	0.00	0.00
In millions of US\$	3.38	1.32	1.13	0.86	0.56	0.34	0.14	0.04	0.00	0.00
In percent of gross international reserves	0.63	0.26	0.24	0.19	0.13	0.07	0.03	0.01	0.00	0.00
In percent of exports of goods and services	0.52	0.19	0.16	0.12	0.08	0.04	0.01	0.00	0.00	0.00
In percent of debt service	25.7	10.7	14.6	7.5	4.5	2.6	0.9	0.2	0.0	0.0
In percent of GDP	0.24	0.09	0.07	0.05	0.03	0.02	0.01	0.00	0.00	0.00
In percent of quota	11.5	4.5	3.8	2.9	1.9	1.2	0.5	0.1	0.0	0.0
Memorandum items:										
Exports of goods and services (in US\$ millions)	645	682	714	727	745	808	947	956	1000	1045
Gross international reserves (in US\$ millions)	537	502	469	461	449	462	475	480	476	467
Debt service (in US\$ millions) 1/	9.3	8.8	5.5	8.1	8.8	9.1	10.9	13.0	15.0	16.7
Quota (in SDR millions)	20.8	20.8	20.8	20.8	20.8	20.8	20.8	20.8	20.8	20.8

Source: IMF staff estimates and projections.  
1/ Total public external debt service, including IMF repayment

**Table 6. Solomon Islands: Alternative Policy Action Scenario 2018–21**  
(In percent of GDP relative to the baseline)

	2018	2019	2020	2021	Fiscal Measures
<b>Revenue</b>	<b>0.5</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>	
Tax Revenue	0.5	0.8	0.8	0.8	
Income and profits	0.1	0.1	0.1	0.1	Reducing tax exemptions and improving administration and compliance
Reducing stock of tax arrears	0.3	0.6	0.6	0.6	Reducing stock of tax arrears: reduce outstanding cases Reducing outstanding returns on hand Strengthening timeframe for prosecution
International trade and transactions	0.1	0.1	0.1	0.1	Tax reference price for logs should be in line with world market prices
<b>Expenditure</b>	<b>-0.3</b>	<b>-1.1</b>	<b>-1.5</b>	<b>-1.5</b>	
Recurrent spending	0.0	-0.5	-0.5	-0.5	
Compensation of employees	0.0	-0.2	-0.2	-0.2	Containing wage bill growth below the nominal GDP growth
Other recurrent spending	0.0	-0.3	-0.3	-0.3	Reducing spending for scholarships and other low-priority spending, such as travel
Development spending	-0.3	-0.6	-0.9	-0.9	
CDFs	-0.2	-0.4	-0.7	-0.7	Reducing CDFs, publish a supplement on CDFs planning, use of funds in 2019 Budget
Other development spending	-0.1	-0.2	-0.2	-0.2	Prioritizing and streamlining development spending: reducing shipping grants
<b>Total Savings</b>	<b>0.8</b>	<b>1.9</b>	<b>2.3</b>	<b>2.3</b>	
Cumulative Savings	0.8	2.7	5.0	7.3	
Adjustment Scenario					
Overall Balance (In percent of GDP)	-2.8	-2.1	-1.6	-1.8	
Cash Balance (in SI\$ millions)	296	278	472	626	
in months of recurrent spending	1.2	1.1	1.8	2.2	
Broader Cash Balance (in SI\$ millions)	436	418	612	766	
in months of total spending	1.3	1.2	1.7	2.0	
Public domestic debt, including arrears (in SI\$ millions)	318	238	238	238	Resolving domestic arrears
Public domestic debt, including arrears (In percent of GDP)	2.8	2.0	1.9	1.8	
Baseline Scenario					
Overall Balance (In percent of GDP)	-3.6	-3.3	-4.0	-4.1	
Cash Balance (in SI\$ millions)	206	122	20	-140	
in months of recurrent spending	0.8	0.5	0.1	-0.5	
Broader Cash Balance (in SI\$ millions)	346	262	160	0	
in months of total spending	1.0	0.7	0.4	0.0	
Public domestic debt, including arrears (in SI\$ millions)	318	318	318	318	
Public domestic debt, including arrears (In percent of GDP)	2.8	2.7	2.5	2.3	
Note: In the adjustment scenario, arrears are cleared by the end of December 2019.					
Source: Staff estimates.					

## Appendix I. Authorities' Response to Fund Policy Advice

Fund Recommendation	Policy Actions
<b>Fiscal Policy</b>	
Rebuild fiscal buffer and stem domestic arrears	The government's broad cash balance fell from the equivalent of 1.9 months of total spending at end-2016 to 1.5 months at end-2017, below the two-month target. Domestic arrears as of end-2017 was cleared by March 2018. The 2018 supplementary budget tries to address the identified arrears that built up in the early month of 2018 but staff believes pressures will reemerge.
Increase fiscal openness, transparency and planning	The 2018 budget documents were published on the website. The 2017 Final Budget Outcome was published in line with the Public Financial Management Act 2013. The tax review was launched
Broaden the tax base and increase revenue transparency	A new Customs and Excise bill (previously an ECF benchmark) was approved by Cabinet in February 2016. There is not yet a firm timeline for presenting the bill to Parliament. The tax review was launched in September 2017 to reform the current tax system. It focuses on modernizing tax administration and considering whether to make the current system work better or to introduce a value-added tax (VAT).
Promote transparency and accountability of public funds	In April 2018, the audit report on the Constituency Development Funds (CDFs) by the Office of Auditor General was published. The report recommended increasing citizen participation in the allocation of CDFs, implementing rigorous reporting and third-party oversight of CDF activities, and expanding project management capacity.
Strengthen public debt management	In September 2016, the debt management framework was revised and strengthened—with new guidelines on direct borrowing, on-lending and guarantees. The government has recently increased a limit for the public debt-to-GDP ratio by five percentage points to 35 percent. The annual borrowing limit in the 2018 budget is SI\$462 million.
<b>Monetary and Financial Sector Policy</b>	
Strengthen supervisory and regulatory framework for the financial system	The Cabinet approved the drafting instructions for a new Financial Institutions Act and started the process to draft a Credit Unions bill to promote financial sector stability and development as part of the benchmarks under the ECF. However, as of July 2018, the bills had not been submitted to Parliament.
Improve the long-term viability of the NPF and reduce financial risks.	Since the Cabinet approval in July 2012 of drafting instructions to revise the NPF Act, no further progress has been made towards passing a new NPF Act (previously an ECF structural benchmark).
Strengthen the monetary transmission mechanism	In March 2015, in line with IMF TA recommendations, the CBSI announced its plans to implement a series of measures—including a potential change in the cash reserve requirement (CRR) ratio and introducing a forex swap facility—to increase the effectiveness of the monetary transmission mechanism. However, the CBSI has remained cautious in raising the CRR ratio.
Increase access to financial services and ensure inclusive growth	The National Financial Inclusion Taskforce released the National Financial Inclusion Strategy 2016–20 (NFIS 2) which will build on the achievements under NFIS 1 and focus, among others, on increasing usage of financial services.
<b>Exchange rate policy and external policy buffer</b>	
Follow the basket peg more closely, including by widening the operational $\pm 1$ percent exchange rate band removed the vis-à-vis the U.S. dollar and re-centering it periodically.	The invoice-based basket peg regime has been fully implemented and the operational band was removed in November 2014 and the basket peg has been applied in line with IMF TA recommendations since then. The authorities have also started publishing information on the exchange rates and the basket peg daily on the CBSI website.
<b>Structural Reforms</b>	
Focus on key areas of infrastructure development and diversifying the sources of growth, with emphasis on access to power, telecommunications, and transportation	Progress has been slow, hampered by many factors, including the closure of the gold mine, and ongoing legal disputes over mining rights for nickel. However, the financing for the Tina River Hydropower Project has been secured, but delays in signing a power purchase agreement are affecting progress on the project. The project is expected to reduce the cost of electricity. Legislative reforms in taxation, the mineral and logging sectors, and measures to curb corruption will contribute to improving the business environment and developing new sources of growth.
Enhance resilience to natural disasters by developing and implementing a multi-pillar strategy at the national, regional, and multilateral levels	The National Development Strategy 2016–35 released in January 2015 envisages higher investment in climate—and natural disaster—proof infrastructure. But depleting fiscal buffers are reducing Solomon Islands' preparedness for a major natural disaster.

## Appendix II. SDGs Identified in the 2016–35 National Development Strategy (NDS)

Key development objectives identified by the NDS	Corresponding SDGs <sup>1/</sup>		Role of the IMF
Sustained and inclusive economic growth	<p>5 Gender Equality</p> <p>8 Inclusive Economic Growth &amp; Decent Work</p>	<p>9 Resilient Infrastructure &amp; Innovation</p> <p>10 Reduced Inequality</p>	<ul style="list-style-type: none"> <li>✓ Assistance in public investment management</li> <li>✓ TA on domestic revenue mobilization</li> <li>✓ TA on financial stability to support financial deepening and inclusion</li> </ul>
Poverty alleviation	<p>1 No Poverty</p> <p>2 Zero Hunger</p>	<p>6 Clean Water &amp; Sanitation</p>	<ul style="list-style-type: none"> <li>✓ Surveillance and policy advice on macro-economic policies</li> </ul>
Access to quality social services	<p>3 Good Health and Well Being</p> <p>4 Quality Education</p>		<ul style="list-style-type: none"> <li>✓ Coordination with the World Bank Group and development partners</li> <li>✓ Emphasis prioritization of expenditure in line with NDS</li> </ul>
Resilient and environmental sustainable development	<p>7 Affordable and Clean Energy</p> <p>11 Sustainable Cities &amp; Communities</p> <p>14 Sustainable Use of Oceans</p>	<p>12 Responsible Consumption</p> <p>13 Climate Action</p> <p>15 Protect Forests &amp; Ecosystems</p>	<ul style="list-style-type: none"> <li>✓ Provide analytical and policy framework on how to incorporate the cost of natural disasters and climate change into the macroframework</li> <li>✓ Capacity development</li> </ul>
Stable and effective governance and public order	<p>16 Peace, Justice, and Strong Institution</p>	<p>17 Partnerships for the Goals</p>	<ul style="list-style-type: none"> <li>✓ TA on PFM with a particular focus on improved medium-term revenue and expenditure forecasting; stronger integration of planning and budgeting within a medium-term framework</li> <li>✓ Focus on governance of logging and mining sectors</li> </ul>

1/ Staff compilation.

Appendix III. Risk Assessment Matrix<sup>1</sup>

Likelihood	Impact / Time Horizon		Policy Response
Medium	<b>High / ST, MT</b> <b>1. Reopening of Gold Ridge mine and beginning of the nickel and bauxite projects</b> Production of mining would contribute to export growth and revenue increase.	Upside	<ul style="list-style-type: none"> <li>Take advantage of upside surprises to lock in an improvement in fiscal buffers.</li> <li>Ensure these new sources of growth are taxed properly.</li> </ul>
	<b>High / ST, MT</b> <b>2. Positive spillovers from large infrastructure projects</b> The implementation of the long-standing plans for large infrastructure projects, such as the Tina Hydropower development project, could have positive spillovers on the economy from 2018 onwards. The completion of the undersea cable projects by the end of 2019 will substantially improve connectivity.		<ul style="list-style-type: none"> <li>Consider ways to use some of the gains to invest in resilient infrastructure.</li> </ul>
High	<b>High / ST, MT</b> <b>1. Fiscal policy slippage</b> Expansionary fiscal policy and weak public financial management increase domestic arrears, resulting in a rise in non-performing loans in the banking sector.	Downside	<ul style="list-style-type: none"> <li>Put in place a plan to eliminate domestic arrears.</li> <li>Consider additional measures to contain discretionary spending.</li> <li>Redouble efforts to contain spending on CDFs, tertiary scholarships and shipping grants.</li> </ul>
	<b>High / ST</b> <b>2. Security risk</b> Security risk may increase in the run-up to the general election, which is expected to be held in early 2019.		<ul style="list-style-type: none"> <li>Ensure adequate financing and continue to strengthen the Royal Solomon Islands Police Force (RSIPF) to maintain peace and stability with continued support from Australia and New Zealand.</li> <li>Continue to push forward with the anti-corruption strategy.</li> </ul>
Low / Medium	<b>High / ST, MT</b> <b>3. Weaker-than-expected global growth</b> Given the increased trade linkages with China, Solomon Islands would be affected by a severe economic slowdown in China. Indirect effects via other regional economies e.g. Australia, would also have an impact.		<ul style="list-style-type: none"> <li>Use policy buffers, including international reserves, to cushion the impact. Seek additional concessional financing to ensure that critical capital expenditure projects can continue.</li> <li>Over time, diversify sources of growth.</li> </ul>
	<b>Medium / ST</b> <b>4. Sharp tightening of global financial conditions:</b> Continued strengthening of the US dollar may pose challenges to effective management of the basket peg, which may exacerbate real exchange rate appreciation and lead to eroding competitiveness. Failure to manage non-US dollar reserves adequately may also lead to significant valuation losses.		<ul style="list-style-type: none"> <li>Continue effective implementation of the basket currency peg in line with IMF TA. Strengthen reserve management, including through Fund TA. Regularly review and realign the basket exchange rate peg with underlying fundamentals and address infrastructure bottlenecks to improve productivity and boost competitiveness.</li> </ul>
Medium/High	<b>High / ST</b> <b>5. Reduced financial services by correspondent banks (de-risking)</b> Solomon Islands sole domestic bank Pan Oceanic Bank (POB) which banks most of the logging industry has lost its last correspondent banking relationship (CBR) for US dollars. A temporary solution is in place and good progress is being made on establishing a new link before the end of 2018 which lessens the immediate vulnerability. But a reemergence of this risk would be a significant adverse shock to the economy given a heavy economic reliance on the logging sector.		<ul style="list-style-type: none"> <li>Reduce environmental concerns logging</li> <li>Take action to address any governance gaps in the bank.</li> <li>Complete establishment of a replacement CBR.</li> <li>Set prudential standards for governance, fit and proper.</li> <li>Strengthen the effectiveness of the AML/CFT framework.</li> <li>Develop contingency plans</li> </ul>
	<b>High / ST, MT</b> <b>6. Natural disasters and climate change</b> Solomon Islands faces many natural disasters, including tropical cyclone, drought, earthquake, tsunami, and flood in the past. The country also faces the risk of adverse effects of volatile weather conditions caused primarily by global warming.		<ul style="list-style-type: none"> <li>Build fiscal buffers against a natural disaster shock.</li> <li>Use space available in the aftermath of a shock to ease the fiscal policy stance and provide a social safety net for those affected. Plan how to adjust back to target once the impact of the shock has diminished.</li> <li>Invest in resilient infrastructure to strengthen climate change mitigation and adaptation.</li> </ul>

<sup>1</sup>The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Nonmutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.



## Appendix IV. PPG External Debt under Alternative Scenarios 2018–28<sup>1</sup>

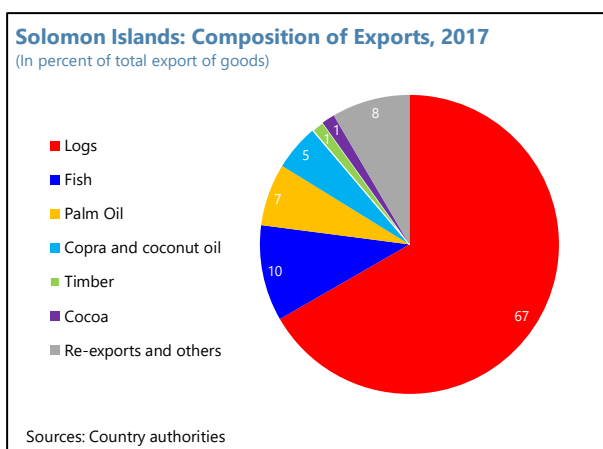


Sources: Country authorities, and staff estimates.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2028. The stress test with a one off breach is also presented (if any), while the oneoff breach is deemed away for mechanical signals. When a stress with oneoff breach happens to be the most extreme shock even after disregarding the one off breach, only that stress test (with a oneoff) breach would be presented.

## Appendix V. Economic Impact of the Loss of CBR <sup>1/</sup>

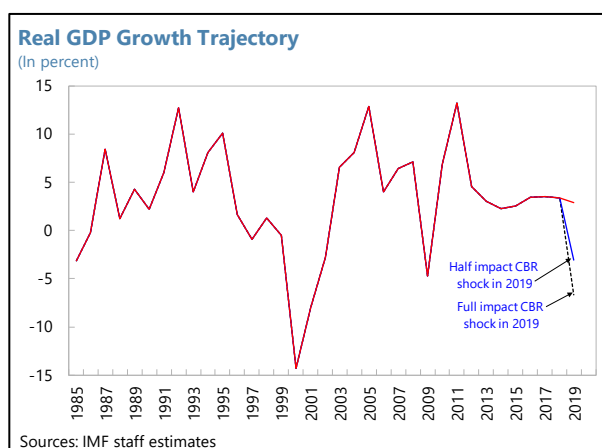
**1. The withdrawal of correspondent banking from a domestic bank could pose a potential downside economic and financial stability risk.** The domestic bank which provides services to most of the logging industry lost its correspondent banking relationship for U.S. dollars and is seeking a replacement. The three foreign banks operating in Solomon Islands are unlikely to take up correspondent banking (CBR) for the logging firms due to governance and environmental concerns about the industry. The CBSI stepped in with a temporary arrangement for the domestic bank until the end of the year and good progress is being made on a permanent solution to establish a new link (once strengthened screening and transaction monitoring is in place), lessening the immediate vulnerability. Nonetheless, there is a downside risk should the anticipated solution not work out or there is a recurrence of the CBR problem.



**2. As logging is the major export of Solomon Islands and an important, though volatile, source of rural income, the loss of US dollar export proceeds could have a significant adverse impact on the economy.** This is against a backdrop where, although the international reserves position is comfortable, the fiscal position is vulnerable and buffers are almost depleted. Since a key driver of the loss of CBR is weak governance in the logging sector, without a substantial improvement in the governance and transparency of the logging sector, there are no easy fixes.

**3. The overall economic impact is highly uncertain, staff considered two possible scenarios:**

- Full impact scenario. The loss of CBR shuts down logging industry exports for one year.
- Half impact scenario. A milder scenario which assumes that logging through different informal channels.



**Impact on Growth:** The main impact on growth is from the direct loss of exports resulting in a cumulative decline of about 9.6 percent in growth during 2019 to a negative 6.7 percent due to a sharp (80 percent) drop in logging output. Growth would decline to a negative 3.1 percent under

<sup>1</sup> Prepared by Stella Kaendera

the half impact scenario. The disruption to growth under the full impact scenario is substantial but less than the GDP contraction of 15 percent in the aftermath of the Asian Financial Crisis and the Tensions.

**External Sector.** The export of logs is only permitted upon the issuance of a Specific Authority to Export granted by the Central Bank and that the proceeds are repatriated within one month. Without the ability to repatriate exports could therefore cease. The full impact and half impact scenarios result in a substantial widening of the current account deficit.

**Fiscal position.** Logging revenue losses from a shutdown of the

logging industry would exacerbate the government's stretched cashflow situation. Without any additional fiscal consolidation measures either on revenues or expenditures, cash reserves would be depleted, resulting in a further accumulation of domestic arrears. Government payment delays to service providers would likely also lead to debt service repayment problems for these borrowers driving a spike in non-performing loans.

#### Solomon Islands: Impact of a Loss of CBR on the Economy

	2019 Proj. (baseline)	2019 Proj. (Full Impact Scenario)	2019 Proj. (Half Impact Scenario)
Real GDP growth	2.9	-6.7	-3.1
Current account balance (percent of GDP)	-8.3	-21.7	-16.5
Gross official reserves (In months of Import)	6.8	4.6	5.5
Revenue 1/ (percent of GDP)	32.2	26.6	28.1
Cash balance (SI\$ million)	262	0	0
Public debt (percent of GDP)	14.6	24.5	21.2

Sources: IMF estimates.

1/ The scenarios do not take into account expenditure measures or aids to cope with a revenue loss.

Sources: IMF estimates.

## Appendix VI. Public Investment Management Assessment (PIMA)<sup>1</sup>

**1. The IMF’s Public Investment Management Assessment (PIMA) is a diagnostic assessment of a country’s public investment management institutions.** The PIMA evaluates infrastructure governance using 15 key institutional features across the three stages of the public investment cycle: (i) planning public investment; (ii) allocating public resources to sectors and projects; and (iii) implementing productive public assets. Staff used a Public Investment Management Diagnostic report compiled by the Pacific Region Infrastructure Facility (PRIF) and judgement to help construct the equivalent of a PIMA for Solomon Islands.<sup>2</sup> The assessment is summarized below.

### (i) Planning

- **Fiscal Principles or Rules.** The public debt threshold is 30 percent of GDP. Given a current low level of debt, the threshold is not binding and so does not provide sufficient discipline for the annual budget process. The cash balance target is two months of total spending, but it has been missed for the past two years. There is no protection for capital spending, as highlighted in a significant cut in government-funded development in 2018.
- **National & Sectoral Plans.** The Medium-Term Development Plan (MTDP) in line with the National Development Strategy 2016–35 (NDS) is published. It includes broad cost estimates of each program. The NDS sets performance indicators and targets as well as responsible entities. Only transport, health, and education, have sectoral plans.
- **Coordination between Entities.** The central government has played a major role in infrastructure development. There is a limited coordination between the central government and provincial and local governments. CDFs are the main sources of local funding.
- **Project Appraisal.** Projects are not systematically subject to cost benefit analyses. There is no standard methodology or central support for project appraisal. The appraisal process conducted by the Ministry of Development Planning and Aid Coordination (MDPAC) does not include an assessment of project feasibility but does include some screening to see if projects are aligned with the NDS.
- **Alternative Infrastructure Financing.** Though a Public Private Partnership (PPP) arrangement was signed between the government and Solomon Islands Chamber of Commerce (SICCI) in July 2017, there is no published policy framework for PPPs. The government does not systematically review the investment plans of public corporations (PCs).

<sup>1</sup> Prepared by Hidetaka Nishizawa.

<sup>2</sup> Pacific Region Infrastructure Facility (2017), “Solomon Islands, Public Investment Management Diagnostic” (<https://www.theprif.org/documents/solomon-islands/other/solomon-islands-public-investment-management-diagnostic>)

**(ii) Allocation**

- **Multiyear Budgeting.** MTDP includes projections of total capital spending over a five-year horizon, but there are no multiyear ceilings on capital expenditure by ministry, sector, or program.
- **Budget Comprehensiveness & Unity.** Most capital projects are included in the budget documentation, but PCs' projects are not shown.
- **Budgeting for Investment.** Under the Public Financial Management (PFM) Act, the Ministry of Finance and Treasury (MOFT) may approve a virement within the agency's budget, but they are required to table them in Parliament.
- **Maintenance Funding.** Though the development budget includes maintenance costs, there is no standard methodology for determining the needs for routine maintenance. Public assets are not adequately maintained.
- **Project Selection.** The government does not publish the criteria or a required process for project selection nor does it maintain a pipeline of appraised investment projects.

**(iii) Implementation**

- **Procurement.** Most projects are tendered in a competitive process through the MOF website, which includes information about pre-qualification and price proposals. The annual tender award report includes winning bidders and amount, but not standard analysis.
- **Availability of Funding.** Cash-flow forecasts are not prepared and the financing of project outlays is subject to cash rationing.
- **Portfolio Management & Oversight.** For most major projects, annual project costs and physical progress are monitored during project implementation. Ex-post reviews of major projects were conducted in 2017 April in the context of the 2016 Development Budget Implementation Report.
- **Management of Project Implementation.** The government assigns senior officers to manage major capital investment projects and implementation plans are submitted for approval. But there are no standardized rules and procedures for project adjustments. Major capital projects are not subject to ex-post external audit.
- **Monitoring of Public Assets.** The Ministry of Infrastructure Development (MID) developed an asset inventory, which is managed and updated periodically. There is no evidence of any asset registry at line ministries except the MID. Government financial accounts do not include the value of non-financial assets. The depreciation of fixed assets is not recorded in operating statement.

## Recommendations

### **2. Based on the weaknesses identified, staff recommends the following points as a first step towards efficient and effective implementation of public investment.**

- Given a limited availability of funds, the government should identify high priority projects, which are in line with the objectives set in the NDS and have a large growth impact.
- Project appraisal should be strengthened by conducting feasibility studies.
- Project selection should be enhanced by publishing or adhering to standard criterion for selection to minimize the political influence.

## Appendix VII. External Sector Assessment

Overall, the external position in FY17 was moderately weaker than that suggested by fundamentals and desirable policies. The current account (CA) deficit is weaker than norm and is expected to remain so from the expectations that investments will continue to be strong. The real exchange rate is moderately stronger than warranted. While reserve coverage continues to be adequate, it is expected to decline over the medium term. The policy mix should aim to boost both private and public investment necessary to increase competitiveness and diversification.

### 1. The EBA Lite analysis suggests that the external sector position is moderately weaker than that consistent with medium term fundamentals and desirable policy settings.

Based on the CA model, the cyclically adjusted CA deficit of 4.0 percent of GDP in 2017 was weaker than the adjusted CA norm by 1.5 percent of GDP suggesting an exchange rate overvaluation of 4.5 percent of GDP. The CA-norm was adjusted by 2.0 percent of GDP to account for a dwindling in aid flows post-RAMSI. Over the longer-term, the CA is expected to remain in deficit on the expectation that investments will continue as suggested by the strong import demand for capital goods.

CA Norm: EBA Lite Analysis (in percent of GDP)	
<b>CA-Actual</b>	<b>-4.1%</b>
Cyclical Contributions (from model)	-0.1%
additional temporary/statistical factors	0
<b>Cyclically adjusted CA</b>	<b>-4.0%</b>
<b>CA-Norm</b>	<b>-5.1%</b>
additional adjustments to the norm	3%
<b>Cyclically adjusted CA Norm</b>	<b>-2.4%</b>
CA-Gap	-1.5%
o/w Policy gap	0.2%
Elasticity	-0.34
REER Gap	4.5%

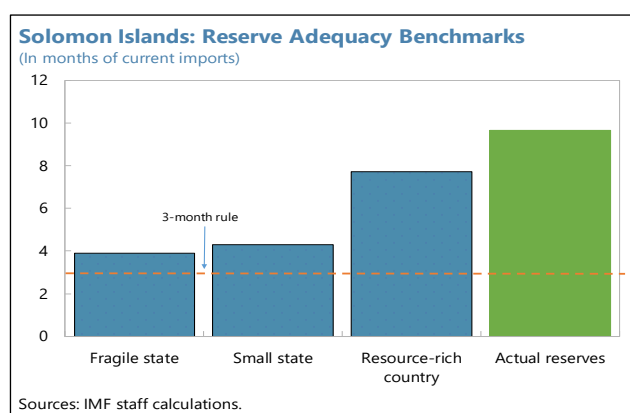
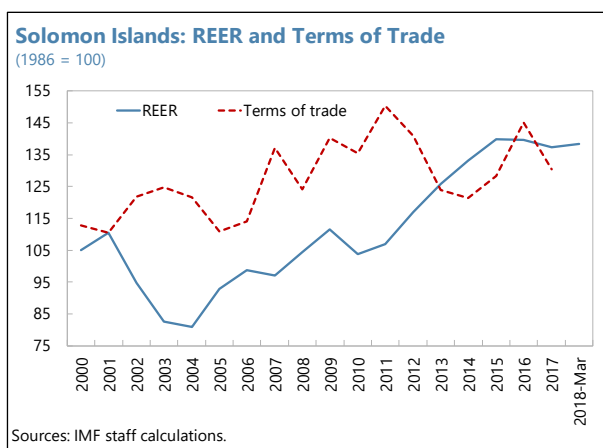
**2. External sustainability benchmarks also support the analysis.** Based on data provided by the authorities, net IIP was -0.3 percent of GDP in 2017, higher than the position reported in the 2017 Article IV assessment. Variations arise from revision in financial liabilities. The External Sustainability (ES) approach results show an overvaluation of 6–10 percent indicating that some REER depreciation would be necessary to sustain the IIP position or narrow the negative net international investment position over the medium-term.

		CA norm (% of GDP)	Underlying CA (% of GDP)	CA gap	REER gap
Scenario 1: Stabilizing net IIP at	-0.3 % of GDP	-3.6	-5.9	-2.3	6.7
Scenario 2: Stabilizing net IIP at	5.0 % of GDP	-3.3	-5.9	-2.6	7.6
Scenario 3: Reaching net IIP at	5.0 % of GDP in 2022	-2.4	-5.9	-3.5	10.2

**3. Real exchange rate.** After a period of sustained appreciation (2014–16), the real exchange depreciated in 2017. This is consistent with the limited flexibility against the US dollar in the basket peg. Although moderately adjusting the balance of weights after 2015 revisions to the formula for the peg, recent trends point to a greater weighting of the US\$ in the basket than that prescribed by the formula. With the recent pickup in inflation and the appreciation in the US\$, the REER is on an upward trajectory again at a time when the terms of trade is deteriorating. While external balance

benefits from a high level of FX reserves and foreign aid, a loss of competitiveness over the medium term could slow growth. In addition to exchange rate flexibility, competitiveness needs to be strengthened by structural, and fiscal policies to ensure external balance in the medium term.

**4. Reserve adequacy. Net international reserves are currently comfortable and in line with reserve adequacy benchmarks.** Applying the staff's reserve adequacy framework for credit-constrained economies and as a resource-rich, fragile, small economy, the adequate level of reserves for Solomon Islands is estimated in the range of 3.9–7.7 months of imports, somewhat lower than the current level of 9.5 months import cover. However, staff expect reserve cover to fall back to around 7.7 months by 2022, equal to the most stringent benchmark. While adequate at their current levels, reserves may decline as the government takes measures for sustainable logging in the forestry sector.

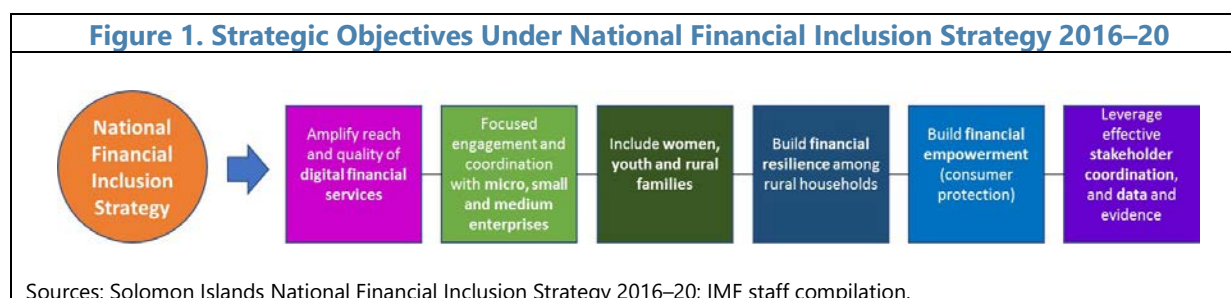




## Appendix VIII. Financial Inclusion and Climate Change

**1. Solomon Islands ranks sixth in the world as a country most highly vulnerable to climate change and natural disasters according to the UN World Risk Index.** The authorities are committed to mitigation and adaptation measures. On mitigation, the authorities' Intended Nationally Determined Contribution (INDC) is to reduce greenhouse gas emissions to 30 percent below 2015 level by 2030, through increased use of renewable energy through hydropower and solar power. On adaptation, the authorities have set National Adaptation Programs of Action (NAPA), including intercropping, resettlement, coastal tree planting, and the use of water tanks. However, implementation of the adaptation and mitigation measures depend on access and the timely provision of financial resources, technology and capacity building support.

**2. Solomon Islands financial inclusion strategy supports achievement of the SDGs and the authorities also want the strategy to complement resiliency building efforts.** Solomon Islands is a member of the Alliance for Financial Inclusion (AFI) and has endorsed Sharm El Sheikh Accord on Financial Inclusion, Climate Change and Green Finance. Members have pledged to incorporate financial inclusion policies and regulatory approaches which positively affect climate change, green finance and sustainable development into their national financial inclusion strategy framework.<sup>1</sup>



**3. The Pacific Islands have underdeveloped financial sectors and there is a lack of insurance provision for households and firms in the region.** Only 7 percent of adults in Solomon Islands have any type of insurance. Experience of other countries demonstrates that the availability of financial products and services, such as savings, credit, and insurance, can help those who are vulnerable to the effects of climate change and natural disasters.

- **Savings can help households smooth consumption in the event of natural disasters.** Savings accounts provide a safer way to store money than saving informally in livestock or

<sup>1</sup> AFI members are central banks and other financial regulatory institutions from more than 90 developing countries, where the majority of the world's unbanked reside. AFI members in the Pacific include Fiji, Papua New Guinea, Samoa, Solomon Islands, Timor-Leste, Tonga, and Vanuatu.

housing that may be negatively affected by climate change. Savings can also boost investments towards agriculture. Anecdotal evidence from Africa shows that farmers provided with saving accounts scaled up investment in agricultural inputs and increased production.

- **Access to credit assists investment in climate-resilient technologies boosting productivity.** In Kenya, for example, asset-collateralized loans increased the take-up of rainwater harvesting tanks, providing dairy farmers reliable access to water and improving their productivity. Research also indicated that aligning the disbursement and repayment of loans to farmers' seasonal cash flows could contribute to an overall increase in investment.
- **Insurance services allows households to spread out risk and provides some protection from losses caused by extreme weather events.** Some African countries, including Kenya, Ethiopia, and Nigeria, have introduced a weather index-based insurance. The insurance, which determines based on a weather index such as rainfalls, allows for quick disbursement and insulates farmers from losses due to weather shocks. In Kenya, insurance based on measurements made at the weather station, allows for quick disbursement through M-PESA, the mobile phone-based payment. Agricultural insurance, which protects against loss of or damage to crops to livestock from natural disasters, is established in some Asian countries, like China and India. However, this insurance is often not commercially viable and expensive of governments.
- **Access to limited early pension withdrawal.** In Fiji and Vanuatu, their National Provident/Pension Funds acted as a disaster relief instrument by allowing their members to withdraw part of pension account balance in the aftermath of a large natural disaster as a temporary measure to cope with member's immediate financing needs. Research conducted by Guo and Narita (2018) shows that a temporary withdrawal can improve welfare, but some restrictions, such as a cap, mandatory contributions and limits on eligibility, are needed to safeguard savings for retirement.<sup>2</sup> To address under-saving by households, the mandatory pension contribution could be raised.
- **Role of government.** The government sector can also play a role. In St. Lucia, for instance, The Climate Adaptation Financing Facility is designed to provide SMEs, community group, and households with concessional loans to promote investments that support climate adaptation or disaster vulnerability reduction. Adoption of this type of facility would need to have strict limits, and an aggregate cap, and be monitored carefully to avoid creating a large fiscal cost.
- **Mobile payments.** As well as fostering financial inclusion, mobile programs have enabled private sector industry development; for example the growth of a private sector solar energy

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<sup>2</sup> Please see the detail in the IMF Working Paper 18/155, "Self-insurance Against Natural Disasters: The Use of Pension Funds in Pacific Island Countries" (<https://www.imf.org/en/Publications/WP/Issues/2018/07/06/Self-insurance-Against-Natural-Disasters-The-Use-of-Pension-Funds-in-Pacific-Island-Countries-45972>)

sector in Africa with solar kits replacing kerosene in some areas, thus contributing to climate mitigation efforts.

**4. Solomon Islands National Financial Inclusion Strategy (NFIS) already covers a range of these areas.** Notable developments include:

- **Informal workers access to the National Provident Fund.** Access to savings and micro insurance (the youSave products) is being expanded to informal workers, who make up close to 80 percent of workers in Solomon Islands. The youSave products have been especially designed for those who are self-employed, such as market vendors, farmers, fishermen, taxi drivers, and contractors. The pilot project ended in December 2017 successfully, with SI\$800,000 savings by 1,200 registered members. In July 2018, the SINPF announced a nationwide rollout of micro pension account for those who work in the informal sectors. This could also enable them to access personal loans, as banks in Solomon Islands secure personal loans against SINPF accounts.
- **Phase 2 of the Financial Inclusion Strategy is focused on mobile accounts usage, a drive for rural savings through financial literacy, saving clubs (SCs) and mobile money, focused on women, youth and families.** SCs provide basic financial service like saving deposits, withdrawals and loans to the people, especially women, in the unbanked remote rural areas. The study conducted by the Pacific Financial Inclusion Program (PFIP) found improvements in saving balances year-on-year for those involved with SCs.

**5. To make further progress the authorities could also consider the following:**

- Consider how financial service providers and government can best leverage the improved connectivity from the undersea cable. Competition among the telecom and internet industries may help bring down costs and improve services.
- Continue to promote new financial technology, such as mobile banking and payments, which help expand financial services, especially in rural areas, as well as facilitate transactions for climate change mitigation and resilience.
- Encourage the private sectors to provide services and products such as weather-index insurance.
- Continue to invest in climate-resilient infrastructure and agriculture. The Tina river hydropower development project, supported by development partners, including Green Climate Funds (GCFs), aims to reduce electricity costs and reliance on diesel imports.
- Consider enabling limited drawdown from SINPF in event of a disaster in return for a higher mandatory contribution but reduce security to banks
- Rebuild fiscal buffers and the contingency fund, complementing the ADB Pacific Disaster Contingent Saving Facility. Once buffers are rebuilt, consideration could be given to a strictly limited facility that offers concessional finance for investment that promotes climate change adaptation.



# SOLOMON ISLANDS

## STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

October 4, 2018

Prepared By

Asia and Pacific Department  
(In consultation with other departments)

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## FUND RELATIONS

(As of July 31, 2018)

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

### General Resources Account:

	SDR Million	Percent of Quota
Quota	20.80	100.00
Fund holdings of currency	17.65	84.87
Reserve position in the Fund	3.15	15.14

### SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	9.91	100.00
Holdings	0.43	4.36

### Outstanding Purchases and Loans: SDR Million                      Percent Quota

	SDR Million	Percent of Quota
ECF Arrangements	1.03	4.93
SCF Arrangements	2.08	10.00

### Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Mission)	Amount Drawn (SDR Million)
ECF	12/7/2012	3/31/2016	1.04	1.04
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:<sup>1</sup>

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

	Forthcoming				
	2018	2019	2020	2021	2022
<b>Principal</b>	<b>0.71</b>	<b>1.46</b>	<b>0.13</b>	<b>0.19</b>	<b>0.21</b>
<b>Charges/Interest</b>	<b>0.04</b>	<b>0.09</b>	<b>0.09</b>	<b>0.09</b>	<b>0.09</b>
<b>Total</b>	<b>0.75</b>	<b>1.55</b>	<b>0.22</b>	<b>0.28</b>	<b>0.30</b>

<sup>1</sup> 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 CCR:** 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. Since the second half of 2014, exchange rate policy management has aimed to keep the value of the basket stable and to avoid real exchange rate misalignment stemming from inflation differentials with trading partners. Solomon Islands maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions. Commercial banks can exchange the Solomon Islands dollar against other currencies and are free to set the bid-ask spread for all currencies except the U.S. dollar and Australian dollar on which there is a spread limit of  $\pm 20$  and  $\pm 25$  basis points, respectively. In addition, the central bank maintains a standing facility through which it will buy and sell foreign exchange with commercial banks and the government at spot offer and sell rates.

**Last Article IV Consultation:** The 2017 Article IV Consultation discussions were held in Honiara during September 19–28, 2017. The staff report (IMF Country Report No. 18/57) was considered by the Executive Board and the consultation concluded on February 16, 2018.

**Technical Assistance:** Technical assistance on public financial management, tax arrears, macroeconomic programming framework, bank supervision, and statistics (GDP and government finance) has been provided mainly through PFTAC.

**Resident Representative:** The resident representative office in the Pacific Islands was opened in September 2010 in Suva, Fiji. Ms. Leni Hunter is the current Resident Representative.

## RELATIONS WITH OTHER IFIS

Relations with other IFIS:

- World Bank Group:  
[http://projects.worldbank.org/search?lang=en&searchTerm=&countrycode\\_exact=SB](http://projects.worldbank.org/search?lang=en&searchTerm=&countrycode_exact=SB)
- Asian Development Bank:  
<https://www.adb.org/countries/solomon-islands/main>
- Pacific Financial Technical Assistance Center:  
[https://www.pftac.org/content/PFTAC/en1/reports11.html#tab\\_5](https://www.pftac.org/content/PFTAC/en1/reports11.html#tab_5)

## STATISTICAL ISSUES

<b>I. Assessment of Data Adequacy for Surveillance</b>	
<b>General:</b> Data provision has some shortcomings but is broadly adequate for surveillance.	
<b>National Accounts:</b> 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 2016 on the production side and the expenditure side were released in February 2018. PFTAC has provided technical assistance to assist with rebasing GDP estimates from 2004 to 2012. Rebased estimates are scheduled to be released by the end of September 2018.	
<b>Price statistics:</b> A monthly consumer price index (CPI) is produced with a short lag (about a month), but only covers the capital Honiara. The authorities are currently expanding the coverage in order to compile a nationwide CPI, with assistance from the Australian Bureau of Statistics. The index weights are also to be revised using the results of the 2012/13 Household Income and Expenditure Survey. A core inflation index was released in December 2013.	
<b>Government finance statistics:</b> 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 unappropriated in the budget. Monthly public sector debt data are published, and the quality of debt data has improved through better coordination between the MOFT and the Central Bank of Solomon Islands (CBSI). The MOFT does not report revenue, expenditure, balance and composition of financing for the general government because it currently does not have the capacity to compile such statistics. PFTAC is working with the authorities to improve the quality of statistics, including expanding institutional coverage.	
<b>Monetary and financial statistics:</b> 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.	
<b>Financial Soundness Indicators:</b> Financial soundness indicators are reported quarterly.	
<b>External Sector Statistics:</b> The CBSI has been compiling quarterly balance of payment (BOPS) and international investment position (IIP) statistics by using data sources such as the Foreign Exchange Transaction System (FET) and different surveys. Coordinated Direct Investment Data (CDIS) have been compiled since 2014. These data are reported to IMF Statistics Department. The BSI has also compiled quarterly Gross External Debt Position Public Sector Debt, Publicly-Guaranteed Private Sector Debt, and Private Sector Debt Not Publicly Guaranteed. These data are disseminated in the World Bank Quarterly External Debt Statistics (QEDS) database. Solomon Islands has been one of the beneficiaries of the Japan Administered Account (JSA) Project on the improvement of external sector statistics (ESS). Several technical assistance (TA) missions have been conducted under this project. The last one was conducted in April 2018. ESS have been improved and are now broadly considered compliant with the <i>BPM6</i> . Despite the progress achieved, limitations in the scope, classifications, and dissemination of ESS remain that distort Solomon Island's external macroeconomic accounts.	
<b>II. Data Standards and Quality</b>	
Solomon Islands is a participant of the Enhanced General Data Dissemination System (e-GDDS).	No data ROSC is available.
<b>III. Reporting to STA (Optional)</b>	
Solomon Islands reports annual government finance statistics to STA. Currently, data are available for budgetary central government for 2011–16.	



### Solomon Islands: Table of Common Indicators Required for Surveillance

(As of September 2018)

	Date of latest observation	Date received	Frequency of Data/7	Frequency of Reporting/7	Frequency of Publication/7
Exchange Rates	Jun-18	July-18	D	W	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities/1	Jun-18	July-18	M	M	M
Reserve/Base Money	Jul-18	Sep-18	M	M	M
Broad Money	Jul-18	Sep-18	M	M	M
Central Bank Balance Sheet	Jul-18	Sep-18	M	M	M
Consolidated Balance Sheet of the Banking System	Jul-18	Sep-18	M	M	M
Interest Rates/2	Jul-18	Sep-18	M	M	M
Consumer Price Index	May-18	July-18	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	Dec-17	Apr-18	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt/5	June-18	July-18	M	M	M
External Current Account Balance	Mar-18	July-18	Q	Q	Q
Exports and Imports of Goods and Services	May-18	July-18	Q	Q	Q
GDP/GNP (GDP production)	2014 (Production 2014)	2015 (Production 2014)	A	A	A
Gross External Debt	Mar-18	July-18	Q	Q	Q
International Investment Position/6	Q4-2017	May-18	Q	Q	Q

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).



# SOLOMON ISLANDS

## STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION— DEBT SUSTAINABILITY ANALYSIS<sup>1</sup>

October 4, 2018

Approved By  
**Odd Per Brekk (IMF)**  
**John Panzer (IDA)**

Prepared By the staff of the International Monetary  
Fund and the International Development Association

<b>Risk of external debt distress:</b>	Moderate
<b>Overall risk of debt distress:</b>	Moderate
<b>Granularity in the risk rating:</b>	Substantial space to absorb shock
<b>Application of judgement:</b>	No

*The external risk of debt distress for Solomon Islands remains moderate. All external debt indicators remain below the relevant indicative thresholds under the baseline scenario, which incorporates the average long-term effects of natural disasters on growth, the fiscal balance, and the current account balance. However, an export shock would cause a prolonged breach of the threshold for the PV of PPG external debt-to-GDP ratio.*

*The overall risk of debt distress is assessed as moderate, with the risk reflecting a deteriorating fiscal position. Though the PV of total public debt-to-GDP ratio remains below the 35 percent benchmark under the baseline scenario, the nominal debt-to-GDP ratio would breach the authorities' target of 35 percent in 2028. Moreover, a shock to real GDP has the greatest impact on the PV trajectory, placing risk at moderate. A tailored natural disaster shock, which uses similar scale to the largest shock in Solomon Islands' history, causes a significant deterioration in debt sustainability in the aftermath of the event. To rebuild fiscal buffers and to enhance resilience against shocks, including natural disaster shocks, both stronger revenue mobilization measures and expenditure rationalization are needed. While the mechanical signal of the DSA suggests there is space to absorb a shock, staff assess such space to be limited, as there are fiscal cashflow problems which are acute, with rising domestic expenditure arrears and a very low cash balance. The sharp cut in development spending for 2018 looks difficult to fully achieve given a significant infrastructure investment gap; and although the authorities made efforts to clear arrears through the Supplementary budget, staff expect pressure on domestic expenditure arrears to reemerge later in the year.*

<sup>1</sup> The Solomon Islands' first Composite Indicator (CI) index, which has been calculated based on the April 2018 WEO, is 2.72, indicating that the country's debt-carrying capacity is medium. However, a first change in the classification of capacity could only take place after such change has been confirmed by a calculation based on the October 2018 WEO, as two consecutive signals are required for a shift in capacity classification according to the new "Guidance Note on the Bank-Fund Debt Sustainability Framework for Low-income Countries" (<http://www.imf.org/en/Publications/Policy-Papers/Issues/2018/02/14/pp122617guidance-note-on-lic-dsf>). Thus, the current debt-carrying capacity (weak for Solomon Islands) based on the latest CPIA continues to apply. The relevant indicative thresholds for this category are: 30 percent for the PV of debt-to-GDP ratio, 140 percent for the PV of debt-to-exports ratio, 10 percent for the debt service-to-exports ratio, and 14 percent for the debt service-to-revenue ratio. These thresholds are applicable to public and publicly guaranteed (PPG) external debt. The benchmark of the PV of total public debt for weak debt carrying capacity is 35 percent.

## PUBLIC DEBT COVERAGE

1. **The coverage of public sector debt used in this report is central government debt, central government-guaranteed debt, and central bank debt, which is borrowed on behalf of the government.**<sup>2</sup> As of end-2017, no central government-guaranteed debt had been recorded; but prospectively, guarantees are anticipated in government's borrowing plan for 2018. The outstanding debts to the IMF stood at US\$6.7 million (0.5 percent of GDP).

Coverage of Public Sector Debt	
Subsectors of the public sector	Sub-sectors covered
1 Central government	X
2 State and local government	
3 Other elements in the general government	
4 o/w: Social security fund	
5 o/w: Extra budgetary funds (EBFs)	
6 Guarantees (to other entities in the public and private sector, including to SOEs)	X
7 Central bank (borrowed on behalf of the government)	X
8 Non-guaranteed SOE debt	

## BACKGROUND ON DEBT

2. **Public debt has increased to 9.4 percent of GDP in 2017 from a historic low level of 7.9 percent in 2016.** The pick-up in debt is due mainly to the SI\$150 million issuance of a domestic development bond in 2017 and disbursements from multilateral creditors. The government successfully reduced debt from 50.3 percent of GDP in 2006 under the 2005 Honiara Club Agreement, which restructured around 10 percent of the stock of external public debt, and a moratorium was placed on debt servicing and new external borrowing. A new debt management framework was introduced in 2012 and revised in 2016 with new guidelines on direct borrowing, on-lending, and guarantees put in place. The debt management strategy sets a limit for the public debt-to-GDP ratio at 35 percent in nominal terms, with debt service to domestically-sourced revenue ratio set at 10 percent.

3. **Public and Publicly Guaranteed (PPG) external debt stood at US\$100 million (7.6 percent of GDP) as of end-2017.** The International Development Association (IDA) and the Asian Development Bank (ADB) account for 29 percent and 36 percent of total public debt respectively. There were no explicit contingent liabilities—public debt guaranteed by the government—in 2017, but the government will provide a guarantee for the ADB's forthcoming US\$15.4 million loan to fund the new University of the South Pacific campus in Solomon Islands. Private sector external debt amounted to 0.8 percent of GDP in 2017.

<sup>2</sup> The authorities have identified non-guaranteed SOE debt as amounting to 1.2 percent of GDP. However, there are a number of data constraints which preclude the inclusion of this information in the debt sustainability analysis. The data shortcomings include no information on the SOEs' debt service and insufficient information on the SOEs' fiscal accounts. In next year's DSA staff will follow up with the authorities to rectify these data shortcomings. For this year's DSA, staff have incorporated non-guaranteed SOE debt in the contingent liability shock scenario by adjusting the default figure by 2 percent of GDP.

**4. Public domestic debt stood at SI\$193 million (1.9 percent of GDP) at end-2017.**<sup>3</sup> The government issued a SI\$150 million domestic development bond in March 2017, purchased by the Solomon Islands National Provident Fund (SINPF). Implicit contingent liabilities—mainly non-guaranteed borrowing by state-owned enterprises (SOEs)—were SI\$121 million (1.2 percent of GDP) at end-2017.

**5. Both domestic and external borrowing are expected to grow in the medium term.** The government has set its annual borrowing limit at SI\$462 million in the 2018 budget to finance key infrastructure projects, including the Tina River hydropower development project (TRHDP), which is supported by many development partners,

including the Green Climate Fund, IDA, ADB, Australia and Korea. The government plans to borrow SI\$30 million during 2018 from the SOEs to resolve domestic arrears.

	In million of SI dollars	In million of US dollars	As a share of total debt	In percent of GDP
Total public debt	980	125	100%	9.4
External	787	100	80%	7.6
Multilateral	703	89	72%	6.8
IDA	288	37	29%	2.8
ADB	349	44	36%	3.4
IMF	53	7	5%	0.5
IFAD	13	2	1%	0.1
Bilateral	84	11	9%	0.8
EXIM Bank (Taiwan province of China)	76	10	8%	0.7
EU	8	1	1%	0.1
Domestic	193	24	20%	1.9
Government domestic bonds	150	19	15%	1.4
Treasury Bills	38	5	4%	0.4
Others	5	1	1%	0.0

Source: Solomon Islands authorities and IMF staff estimates.

## BACKGROUND ON MACRO FORECASTS

**6. The assumptions in the baseline scenario are consistent with the macroeconomic framework presented in the staff report.** Similar to the last DSA, the baseline scenario incorporates the effects of

natural disasters and climate change over the longer-term, with an overall view lying slightly to the downside vis-à-vis the 2017 report. The years 2018–23 are assumed to be disaster free to simplify the policy discussion of the near-term outlook. However, from 2024 onwards, the baseline incorporates the average

long-term effects of natural disasters and climate change by lowering GDP growth by 0.3 percentage points (pps) annually, raising the current account deficit by 0.5 pps and increasing the fiscal deficit by 0.2 pps vis-à-vis disaster-free projections to reflect the country's historical experience. These are consistent

	2018 DSA	2017 DSA
	2018-28 ave.	2017-27 ave.
Real GDP growth	2.9	3.0
GDP deflator in US dollar terms (change in percent)	4.2	3.7
Non-interest current account deficit	7.2	5.8
Net FDI (negative = inflow)	-3.1	-3.6
Primary deficit	3.5	3.4

Source: IMF staff projections.

<sup>3</sup> This excludes domestic arrears of SI\$138 million at end-2017, which were cleared by March 2018.

with the findings of staff's research on the impact of natural disasters.<sup>4</sup> The discount rate used to calculate the net present value of external debt remains at 5 percent. The main assumptions are:

- **Real GDP growth** is projected at 2.9 percent on average during 2018–28. The projection takes into account three factors: (i) on the upside, higher capital spending on key infrastructure projects, including TRHDP and the undersea cable project, pushes growth up; on the downside, there are: (ii) continued fiscal problems that would negatively affect private sector activity; and (iii) a decline in logging activity, which might be offset over the medium term by an expected rise in mining activity.
- **Inflation** (measured by GDP deflator in USD terms) is projected to average 4.2 percent during 2018–28, higher than last year's projection due mainly to a recovery in oil prices.
- **Non-interest current account deficit** is projected to rise to 7.2 percent of GDP on average over 2018–28, reflecting the high import content for key infrastructure projects and lower exports due to a long-term decline in logging activities. The reopening of the gold mine in Guadalcanal and the resumption of exports is now expected to be delayed until 2023.
- **FDI inflows** are expected to increase on average to about 3.1 percent of GDP over 2018–28, slightly lower than last year's projection due to worsening business sentiment caused by the government's cash-flow problems.
- **Logging output** is expected to be slightly lower in the next couple of years and then to start declining on average by 1.1 percent a year from 2023.
- **Mining production** is expected to start over the longer term. Gold production is assumed to resume in 2023 and is assumed to peak from 2024 to 2027 and then to decrease gradually. Other mining activity (nickel and bauxite) is expected to come fully onstream in the long run, this is implicitly assumed to add a small impetus to long-term growth rates.
- **External borrowing and grants:** New disbursements for projects in the pipeline, including TRHDP, are expected to take place in the next five years (2018–22). From 2023 onwards, the level of new annual external borrowing is expected to be around 3 percent of GDP. Grant and lending flows from multilateral development partners are expected to increase over the medium term due to the scale-up of IDA and ADB financing, and are partly offset by lower financing from other development partners. Grants and the grant element of new borrowing are expected to decline over the medium term.
- **Fiscal outlook:** The ten-year forward-looking average of the primary deficit is expected to remain high at 3.5 percent of GDP, reflecting the recent worsening of the fiscal position that has resulted in a buildup in domestic arrears. By 2021, when the cash balance is positive, the deficit will be financed by cash reserves. Once depleted, the government is expected to seek domestic borrowing from SOEs. The accumulation of new domestic arrears is included in public debt during the projection period.

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<sup>4</sup> Please see the detail in the IMF Working paper 18/108, "The Economic Impact of Natural Disaster in Pacific Island Countries" (<https://www.imf.org/en/Publications/WP/Issues/2018/05/10/The-Economic-Impact-of-Natural-Disasters-in-Pacific-Island-Countries-Adaptation-and-45826>).

7. **The new realism tools suggest that our projections are reasonable (Figure 4).** The three-year adjustment in the primary balance is expected to be zero, suggesting there is no fiscal adjustment between 2017 and 2020 (3.7 percent of GDP). The assumption on real growth in 2018 and 2019 is slightly lower than possible growth paths which are calculated based on one-year fiscal adjustment. Two charts on public and private investment rates and contribution to real GDP growth are not available due to a lack of data.

## COUNTRY CLASSIFICATION

8. **As discussed in footnote 1, the country's debt-carrying capacity applied in the 2018 DSA is weak.** The Solomon Islands' first Composite Indicator (CI) index, which has been calculated based on the April 2018 WEO, is 2.72, indicating that the country's debt-carrying capacity would be medium in the revised LIC-DSF framework. But a change in the classification needs await second appraisal, as two consecutive signals are required to confirm a shift in debt carrying capacity. Hence, this DSA is based on the weak category ratings.

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	2.967	1.14	42%
Real growth rate (in percent)	2.719	2.885	0.08	3%
Import coverage of reserves (in percent)	4.052	57.963	2.35	86%
Import coverage of reserves <sup>2</sup> (in percent)	-3.990	33.597	-1.34	-49%
Remittances (in percent)	2.022	0.000	0.00	0%
World economic growth (in percent)	13.520	3.660	0.49	18%
<b>CI Score</b>			<b>2.72</b>	<b>100%</b>
<b>CI rating</b>			<b>Medium</b>	

9. **The relevant indicative thresholds for the weak category are: 30 percent for the PV of debt-to-GDP ratio, 140 percent for the PV of debt-to-exports ratio, 10 percent for the debt service-to-exports ratio, and 14 percent for the debt service-to-revenue ratio.** These thresholds are applicable to public and publicly guaranteed (PPG) external debt. The benchmark for the PV of total public debt under weak debt carrying capacity is 35 percent. Should debt-carrying capacity change to medium, the thresholds and benchmark would increase.

Debt carrying capacity (CI classification)	PV of PPG external debt in percent of		PV of PPG external debt in percent of		PV of total public debt in percent of
	GDP	Exports	Exports	Revenue	GDP
<b>Weak</b>	30	140	10	14	35
<b>Medium</b>	40	180	15	18	55
<b>Strong</b>	55	240	21	23	70

## DETERMINATION OF SCENARIO STRESS TEST

**10. Given the severity and frequency of natural disasters in the Solomon Islands, a tailored stress test for a natural disaster shock was conducted.** Solomon Islands, which is defined as a small developing natural disaster-prone state in the IMF board paper on small states, is automatically subject to the LIC-DSF standard natural disaster shock.<sup>5</sup> Default parameters for this test were altered, based on EM-DAT, the international disaster database, to reflect the country's largest damage from natural disasters (over 1980–2016) at 14 percent of GDP. Thus, the DSA assumes a one-off shock of 14 pp of GDP to the debt-GDP ratio in 2019 and a reduction of real GDP growth and exports by 2.5 and 7.0 pps respectively.<sup>6</sup>

**11. A stress test for the combined contingent liability shock adjusts the default setting for SOE debt.** To reflect the current level of implicit contingent liabilities (1.2 percent of GDP), we adjust the magnitude of the shock of SOE debts from the default value of 2 percent, which is the median SOE external liability identified by a Fund staff survey conducted in 2016. We use the default value of 5 percent for financial markets.

Combined Contingent Liability Shock			
Combined Contingent Liability Shock			
1 The country's coverage of public debt	The central government, central bank, government-guaranteed debt		
	Default	Used for the analysis	Reasons for deviations from the default settings
2 Other elements of the general government not captured in 1.	0 percent of GDP	0.0	
3 SoE's debt (guaranteed and not guaranteed by the government) 1/	2 percent of GDP	1.2	To reflect the size of implicit contingent liabilities
4 PPP	35 percent of PPP stock	0.0	
5 Financial market (the default value of 6 percent of GDP is the minimum value)	5 percent of GDP	5.0	
Total (2+3+4+6) (in percent of GDP)		6.2	

1/ The default shock of 2% of GDP will be triggered for countries, whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

## DEBT SUSTAINABILITY

### A. External Debt Sustainability Analysis

**12. Under the baseline scenario, all external PPG debt indicators remain below the policy relevant thresholds for the next ten years (Figure 1).** The PV of debt-to GDP ratio is expected to increase gradually from 5.3 percent in 2017 to 15.4 percent in 2028 due mainly to new disbursements for key infrastructure projects, including the TRHDP. As Figure 3 shows, the main driver of debt dynamics during the projection period is the current account deficit. Even under the 20-year forecast horizon, which was used in the previous framework, there would be no breach for all debt indicators in the baseline scenario, although debt ratios continue to rise.

**13. The standardized stress test shows that an export shock has the largest negative impact on the debt trajectory, causing a breach of the threshold for the PV of debt-to-GDP ratio.** This suggests the need to expand the export base, as logging exports are expected to decline over the longer run. Other

<sup>5</sup> One-off shock of 10 percentage points to debt-GDP ratio in the second year of the projection period (2019 for this case). Real GDP growth and exports are lowered by 1.5 and 3.5 percentage points, respectively, in the year of the shock.

<sup>6</sup> Please see footnote 3.



shocks, including to real GDP growth, the primary balance, and a one-time 30 percent depreciation, do not lead to a breach of the debt threshold (Table 3).

**14. The tailored natural disaster shock causes the debt trajectory for each indicator to move upward in the aftermath of the shock.** Though the DSA assumes a one-off shock that takes place in 2019, there is a possibility that multiple severe natural disasters could occur within a ten-year timeframe. Staff's work shows that there is a probability of around 13.5 percent of a disaster each year of a magnitude of more than 7.1 percent of damage-to-GDP ratio or 7.5 percent of the population affected-to-total population ratio. This probability translates into one shock every seven years. Multiple natural disasters would carry a larger cumulative effect on debt sustainability through damaging long-term growth and increasing borrowing for reconstruction needs.

## B. Public Sector Debt Sustainability Analysis

**15. Under the baseline scenario, the PV of public debt-to-GDP ratio does not breach the 35 percent benchmark (Figure 2).** However, the nominal public debt-to-GDP ratio would rise from 9.4 percent and breaches the authorities' threshold of 35 percent in nominal terms in 2028 (Table 2). As Figure 3 indicates, the breach is primarily driven by a primary deficit caused by continued expansionary fiscal policy.

**16. The standardized sensitivity analysis shows that the largest shock that leads to the highest debt/GDP figures in 2028 is that to real GDP growth (Figure 2, Table 4).** The PV of debt-to-GDP ratio would reach 56 percent of GDP in 2028. The vulnerability to a shock to real GDP growth highlights the need for stronger growth in the medium term.

**17. The tailored natural disaster shock results in a sharper deterioration in debt sustainability.** The PV of public debt-to-GDP ratio would breach its threshold of 35 percent in 2026. This highlights the importance of rebuilding fiscal buffers against external shocks.

**18. A tailored stress test for the combined contingent liability shock also causes a deterioration in debt sustainability.** The trajectory of the PV of public debt-to-GDP ratio moves upwards by 2.5-4.2 percentage points from the baseline. This suggests the need for government to rebuild fiscal buffers to address the contingent liability shock.

## RISK RATING AND VULNERABILITIES

**19. The debt sustainability analysis under the new LIC DSF framework suggests that Solomon Islands' risk of external debt distress remains moderate.** While there is no breach of external debt thresholds under the baseline, standardized stress tests indicate that an export shock would result in a breach of the threshold for the PV of external debt-to-GDP ratio. This underscores the importance of broadening the export base given an expected long-term decline in logging exports. Even though debt service indicators remain well below their thresholds both under the baseline and stress test scenarios, maximizing concessional loans would help keep the debt burden contained. Regarding the granularity in the risk rating, Figure 5 suggests that there is a substantial space to absorb shocks, reflecting a current low level of external debt; but staff assess that given current concerns about the deterioration in the fiscal



position, it would need to be placed on a firmer footing to create an environment for higher-debt take up.<sup>7</sup> Also, it would be difficult for Solomon Islands to scale up rapidly without hitting absorptive capacity constraints.

**20. The DSA suggests that overall risk of debt distress is moderate, reflecting the recent expansionary fiscal policy and a buildup of domestic arrears.** The nominal debt-to-GDP ratio would breach the authorities' target of 35 percent in 2028, though not the benchmark for the PV of public debt as determined by the country's debt carrying capacity. A shock to real GDP growth has the largest impact on public debt sustainability, leading the PV of debt-to-GDP ratio to reach 56 percent in 2028. These results indicate the urgent need for fiscal adjustment and measures to boost potential growth in the long run. The tailored stress test for a natural disaster shock would affect debt sustainability quite adversely; that for the contingent liability shock more moderately. The authorities need to embark on fiscal consolidation measures to rebuild fiscal buffers and prioritize investment projects that build resilience to natural disasters.

## AUTHORITIES' VIEW

**21. The authorities broadly agree with the assessment of debt sustainability analysis under the new framework and support the tailored natural disaster stress test.** They increased their nominal debt threshold from 30 percent to 35 percent of GDP recently to address large infrastructure needs, including for the Tina River hydropower project. Though the current debt level is relatively low, they continue to seek concessional loans or external grants to keep the debt burden subdued. They are beginning to prepare for the 2023 Pacific Games, but no decisions have yet been taken on borrowing or guarantees arising from infrastructure development related to the Games. The authorities recognize the risks that large borrowing in the context of such event would pose and are aware that such borrowing would adversely affect debt sustainability. The authorities intend to maintain around SI\$40 million for the T-bill market and to seek borrowing from SOEs so as to clear all domestic arrears by end-2018. They emphasized that they had a firm intention to clear all domestic arrears by the end of the year which was being achieved through the sharp cut back in development spending. They noted that they are mindful of implicit contingent liability mainly from non-guaranteed SOE debt. In line with the public financial management act, they can require all SOEs to acquire consent from the Minister of Finance to undertake direct borrowing.

<sup>7</sup> The space is measured by the distance between the baseline debt burden indicators and their thresholds.

**Table 1. Solomon Islands: External Debt Sustainability Framework, Baseline Scenario, 2015–38**  
(In percent of GDP, unless otherwise indicated)

	Actual			(In percent of GDP, unless otherwise indicated)								Average 8/	
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028	2038	Historical	Projections
<b>External debt (nominal) 1/</b>	10.6	8.2	8.4	10.2	12.6	15.3	17.7	19.4	20.9	26.9	30.3	19.9	20.0
<i>of which: public and publicly guaranteed (PPG)</i>	9.7	7.5	7.6	9.3	11.6	14.3	16.6	18.2	19.7	25.3	28.4	13.9	18.1
Change in external debt	-1.4	-2.4	0.2	1.8	2.4	2.8	2.4	1.7	1.5	1.0	0.0		
Identified net debt-creating flows	0.8	0.4	1.8	4.0	4.8	5.1	3.6	3.6	3.2	3.9	3.0	0.3	3.8
Non-interest current account deficit	2.8	3.8	4.1	6.3	8.2	8.6	7.2	7.1	6.5	7.4	6.4	9.3	7.2
Deficit in balance of goods and services	8.1	5.8	5.8	8.0	10.4	10.9	11.4	11.7	11.2	13.3	15.2	12.4	10.9
Exports	45.5	44.9	45.6	45.3	45.1	44.5	42.3	40.6	41.0	39.1	26.2		
Imports	53.5	50.7	51.4	53.3	55.5	55.3	53.7	52.3	52.3	52.4	41.4		
Net current transfers (negative = inflow)	-7.1	-5.2	-4.3	-4.9	-5.3	-5.5	-6.0	-6.2	-6.7	-7.6	-5.4	-13.0	-6.3
<i>of which: official</i>	-8.1	-7.1	-7.9	-8.2	-8.3	-8.2	-8.3	-8.2	-8.4	-8.2	-5.2		
Other current account flows (negative = net inflow)	1.9	3.2	2.5	3.2	3.1	3.3	1.8	1.6	2.0	1.7	-3.3	9.9	2.6
Net FDI (negative = inflow)	-2.4	-2.9	-2.0	-2.2	-3.2	-3.4	-3.5	-3.2	-3.1	-3.2	-3.1	-7.1	-3.1
Endogenous debt dynamics 2/	0.4	-0.5	-0.3	-0.1	0.1	0.2	0.2	0.2	0.2	-0.2	-0.4		
Contribution from nominal interest rate	0.2	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.3	0.4	0.5		
Contribution from real GDP growth	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.4	-0.4	-0.5	-0.8	-0.9		
Contribution from price and exchange rate changes	0.5	-0.3	-0.1	...	...	...	...	...	...	...	...		
Residual 3/	-2.3	-2.7	-1.6	-2.2	-2.4	-2.3	-1.3	-1.9	-1.6	-2.8	-3.0	-3.6	-2.1
<i>of which: exceptional financing</i>	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
<b>Sustainability indicators</b>													
PV of PPG external debt-to-GDP ratio	...	...	5.3	6.0	7.1	8.6	9.9	10.7	11.7	15.4	19.6		
PV of PPG external debt-to-exports ratio	...	...	11.7	13.3	15.7	19.4	23.3	26.4	28.4	39.5	74.8		
PPG debt service-to-exports ratio	1.5	1.8	1.7	1.4	1.3	0.8	1.1	1.2	1.1	1.8	5.3		
PPG debt service-to-revenue ratio	2.0	2.6	2.4	2.0	1.8	1.1	1.5	1.5	1.5	2.2	4.7		
Gross external financing need (Million of U.S. dollars)	31.0	30.9	37.9	69.3	84.1	91.1	73.9	80.5	77.3	140.8	283.3		
<b>Key macroeconomic assumptions</b>													
Real GDP growth (in percent)	2.5	3.5	3.5	3.4	2.9	2.8	2.7	2.7	2.8	3.1	3.2	4.2	2.9
GDP deflator in US dollar terms (change in percent)	-3.8	3.0	1.5	6.2	3.1	3.5	4.1	3.9	4.6	4.0	4.5	5.5	4.2
Effective interest rate (percent) 4/	1.6	1.3	1.5	1.5	1.5	1.5	1.5	1.4	1.4	1.5	1.7	2.3	1.5
Growth of exports of G&S (US dollar terms, in percent)	-7.1	5.4	6.6	9.0	5.6	4.8	1.8	2.4	8.6	4.8	-3.1	12.4	5.9
Growth of imports of G&S (US dollar terms, in percent)	-9.3	1.0	6.5	13.9	10.5	6.0	3.7	4.0	7.4	7.4	7.1	7.8	7.5
Grant element of new public sector borrowing (in percent)	...	...	...	45.5	47.9	46.2	46.7	49.7	43.9	41.9	30.6	...	46.2
Government revenues (excluding grants, in percent of GDP)	35.1	31.7	32.5	32.4	32.2	32.0	31.7	31.6	31.4	31.0	29.8	32.0	31.7
Aid flows (in Million of US dollars) 5/	258.7	230.3	231.9	180.1	202.1	210.4	219.5	230.2	241.0	332.2	615.6		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	12.2	12.6	12.4	12.1	11.9	11.7	11.4	10.6	...	11.9
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	88.7	87.9	86.5	86.6	88.8	87.5	86.7	83.6	...	87.7
Nominal GDP (Million of US dollars)	1,158	1,235	1,298	1,424	1,511	1,607	1,718	1,833	1,970	2,802	5,836		
Nominal dollar GDP growth	-1.3	6.6	5.1	9.7	6.1	6.4	6.9	6.7	7.5	7.2	7.8	10.2	7.3
<b>Memorandum items:</b>													
PV of external debt 7/	...	...	6.2	6.9	8.1	9.6	11.0	11.9	12.9	17.0	21.5		
In percent of exports	...	...	13.6	15.2	17.9	21.7	25.9	29.3	31.5	43.5	81.9		
Total external debt service-to-exports ratio	4.9	3.6	1.9	1.6	1.5	0.9	1.2	1.3	1.3	1.9	5.7		
PV of PPG external debt (in Million of US dollars)	...	...	69.4	85.5	107.3	138.4	169.3	196.3	230.0	432.8	1143.6		
(PVt-PVt-1)/GDPt-1 (in percent)	...	...	1.2	1.5	2.1	1.9	1.6	1.8	1.9	1.7	1.7		
Non-interest current account deficit that stabilizes debt ratio	4.3	6.2	3.9	4.5	5.8	5.8	4.9	5.4	5.0	6.4	6.5		

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as  $[r - g - \rho(1+g) + E\alpha(1+i)] / (1+g+p+g)$  times previous period debt ratio, with  $r$  = nominal interest rate;  $g$  = real GDP growth rate,  $\rho$  = growth rate of GDP deflator in U.S. dollar terms,  $E$  = nominal appreciation of the local currency, and  $\alpha$  = share of local currency-denominated external debt in total external debt.

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

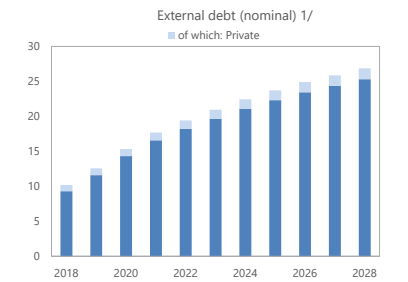
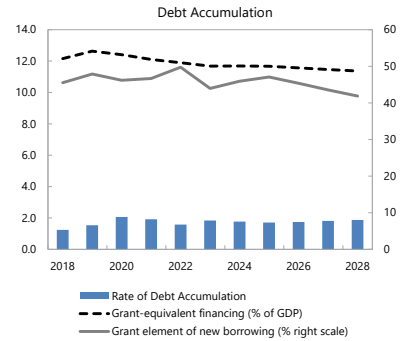
5/ Defined as grants, concessional loans, and debt relief.

6/ 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).

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

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Definition of external/domestic debt	Residency-based
Is there a material difference between the two criteria?	No



**Table 2. Solomon Islands: Public Sector Debt Sustainability Framework, Baseline Scenario, 2015–38**  
(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028	2038	Historical	Projections
<b>Public sector debt 1/</b>	10.1	7.9	9.4	12.1	14.6	17.6	20.6	23.4	26.1	35.5	43.2	19.0	25.0
of which: external debt	9.7	7.5	7.6	9.3	11.6	14.3	16.6	18.2	19.7	25.3	28.4	13.9	18.7
Change in public sector debt	-1.8	-2.2	1.5	2.7	2.4	3.1	3.0	2.8	2.7	1.6	0.4		
Identified debt-creating flows	0.0	3.4	3.1	2.9	2.6	3.2	3.1	2.9	2.8	1.7	0.4	-4.3	2.5
Primary deficit	-0.4	3.8	3.7	3.4	3.1	3.7	3.8	3.8	4.0	3.1	2.4	-2.2	3.5
Revenue and grants	47.9	43.1	42.7	43.3	43.2	42.7	42.2	42.0	41.8	41.1	39.5	50.5	42.1
of which: grants	12.9	11.4	10.2	10.9	11.0	10.7	10.5	10.4	10.4	10.1	9.7		
Primary (noninterest) expenditure	47.5	47.0	46.4	46.7	46.3	46.4	46.0	45.8	45.7	44.2	41.9	48.3	45.5
Automatic debt dynamics	0.4	-0.4	-0.6	-0.5	-0.5	-0.5	-0.7	-0.9	-1.1	-1.4	-2.0		
Contribution from interest rate/growth differential	-0.4	-0.4	-0.3	-0.3	-0.3	-0.3	-0.5	-0.6	-0.7	-0.9	-1.3		
of which: contribution from average real interest rate	-0.1	0.0	0.0	0.0	0.0	0.1	0.0	-0.1	-0.1	0.1	0.0		
of which: contribution from real GDP growth	-0.3	-0.3	-0.3	-0.3	-0.3	-0.4	-0.5	-0.5	-0.6	-1.0	-1.3		
Contribution from real exchange rate depreciation	0.8	0.0	-0.4	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	0.0
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (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		
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 debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	-1.7	-5.6	-1.6	-0.4	-0.3	-0.3	-0.4	-0.4	-0.5	-0.6	-0.8	0.9	-0.5
<b>Sustainability indicators</b>													
PV of public debt-to-GDP ratio 2/	...	...	7.1	8.8	10.0	11.9	13.9	15.9	18.1	25.6	34.4		
PV of public debt-to-revenue and grants ratio	...	...	16.6	20.4	23.3	27.9	33.0	37.8	43.4	62.4	87.0		
Debt service-to-revenue and grants ratio 3/	5.5	3.0	2.9	2.6	2.4	2.5	3.9	6.0	5.9	6.3	17.8		
Gross financing need 4/	2.1	5.0	4.9	4.5	4.1	4.7	5.5	6.3	6.4	5.7	9.5		
<b>Key macroeconomic and fiscal assumptions</b>													
Real GDP growth (in percent)	2.5	3.5	3.5	3.4	2.9	2.8	2.7	2.7	2.8	3.1	3.2	4.2	2.9
Average nominal interest rate on external debt (in percent)	0.9	1.0	1.2	1.1	1.2	1.2	1.2	1.2	1.2	1.2	1.5	1.3	1.2
Average real interest rate on domestic debt (in percent)	-0.7	-0.6	-0.3	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	0.0	-0.1	-0.4
Real exchange rate depreciation (in percent, + indicates depreciation)	8.1	-0.4	-5.2	...	...	...	...	...	...	...	...	-3.7	...
Inflation rate (GDP deflator, in percent)	3.1	3.6	2.7	4.2	3.4	3.5	4.1	3.9	4.6	4.0	4.5	5.9	4.0
Growth of real primary spending (deflated by GDP deflator, in percent)	8.1	2.2	2.3	4.1	2.0	3.1	1.8	2.1	2.7	2.5	2.9	5.0	2.5
Primary deficit that stabilizes the debt-to-GDP ratio 5/	1.3	6.1	2.2	0.7	0.6	0.6	0.8	1.0	1.2	1.5	2.1	3.2	1.1
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central government, central bank, government-guaranteed debt. Definition of external debt is Residency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

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

4/ 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 and other debt creating/reducing flows.

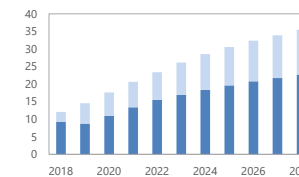
5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio (i.e., a primary surplus), which would stabilize the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

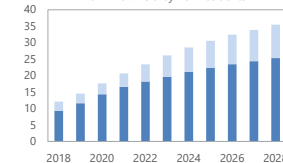
Definition of external/domestic debt	Residency based
Is there a material difference between the two criteria?	No

Public sector debt 1/

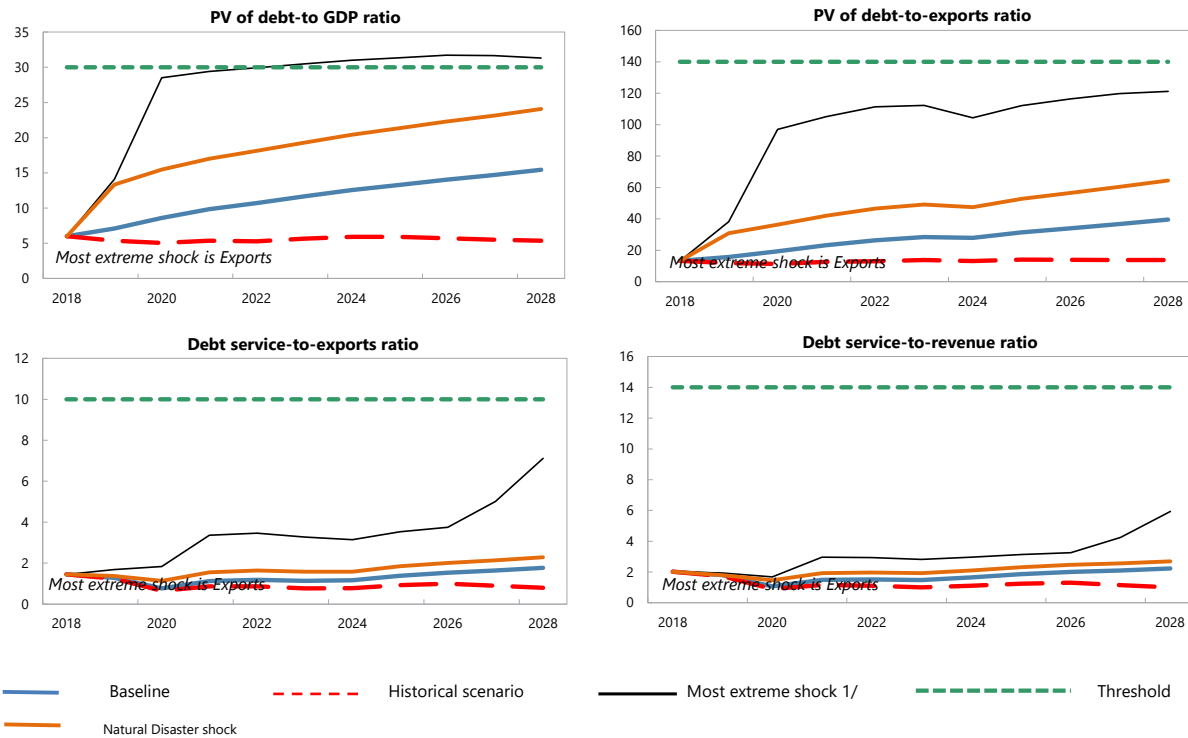
■ of which: local-currency denominated  
■ of which: foreign-currency denominated



■ of which: held by residents  
■ of which: held by non-residents



**Figure 1. Solomon Islands: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2018–28 1/**



Customization of Default Settings		
	Size	Interactions
<b>Tailored Tests</b>		
Combined CLs	Yes	
Natural Disasters	Yes	Yes
Commodity Prices <sup>2/</sup>	n.a.	n.a.
Market Financing	n.a.	n.a.

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing Assumptions for Stress Tests*		
	Default	User defined
<b>Shares of marginal debt</b>		
External PPG MLT debt	100%	
<b>Terms of marginal debt</b>		
Avg. nominal interest rate on new borrowing in USD	1.3%	1.3%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	31	31
Avg. grace period	7	7

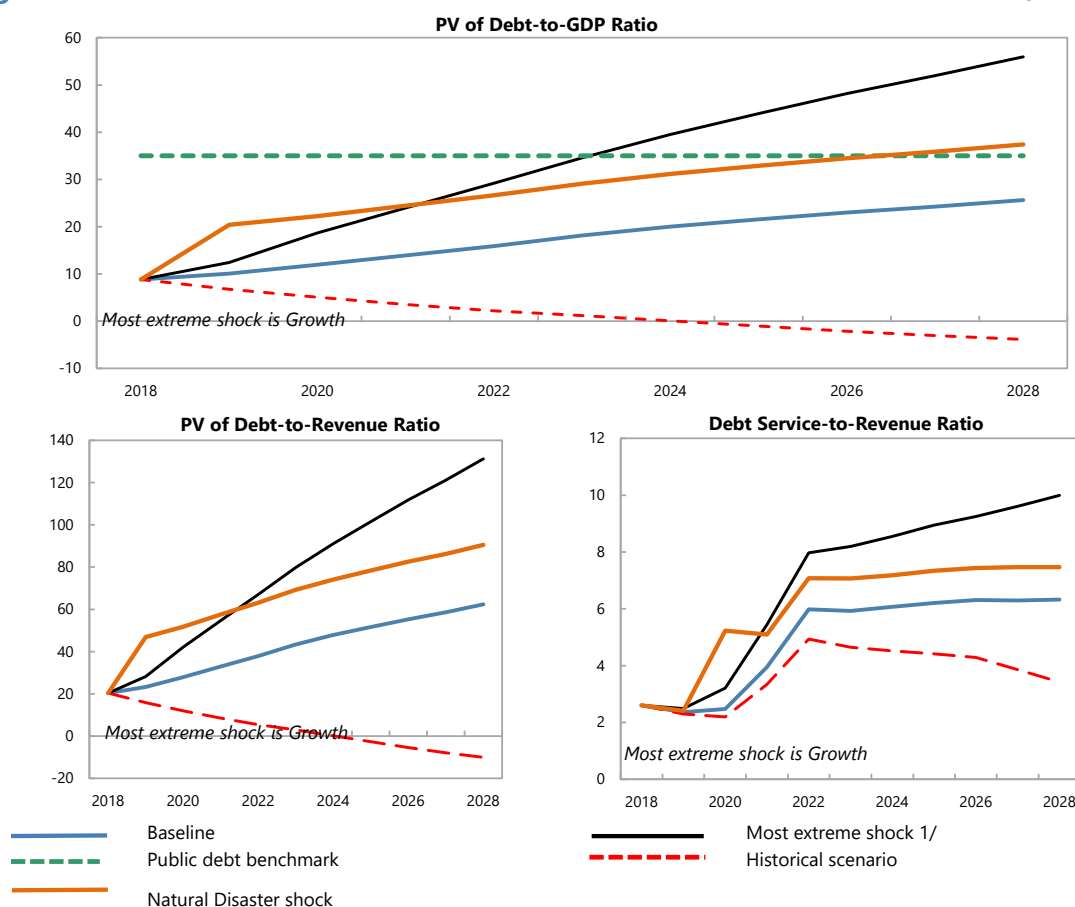
\* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2028. Stress tests with one-off breaches are also presented (if any), while these one-off breaches are deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

**Figure 2. Solomon Islands: Indicators of Public Debt Under Alternative Scenarios, 2018–28 1/**



Borrowing Assumptions for Stress Tests*	Default	User defined
<b>Shares of marginal debt</b>		
External PPG medium and long-term	73%	73%
Domestic medium and long-term	21%	21%
Domestic short-term	33%	6%
<b>Terms of marginal debt</b>		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	1.3%	1.3%
Avg. maturity (incl. grace period)	31	31
Avg. grace period	7	7
Domestic MLT debt		
Avg. real interest rate on new borrowing	2.3%	2.3%
Avg. maturity (incl. grace period)	15	15
Avg. grace period	14	14
Domestic short-term debt		
Avg. real interest rate	-3%	-3.0%

\* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2028. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

**Table 3. Solomon Islands: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2018–28**  
(In percent)

	Projections										
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
<b>PV of debt-to-GDP ratio</b>											
<b>Baseline</b>	6.0	7.1	8.6	9.9	10.7	11.7	12.6	13.3	14.0	14.7	15.4
<b>A. Alternative Scenarios</b>											
A1. Key variables at their historical averages in 185-2628 1/	6.0	5.4	5.0	5.4	5.3	5.6	5.9	5.9	5.7	5.5	5.4
<b>B. Bound Tests</b>											
B1. Real GDP growth	6.0	7.6	9.9	11.4	12.4	13.5	14.5	15.3	16.2	17.0	17.8
B2. Primary balance	6.0	8.7	12.0	13.3	14.1	15.0	15.8	16.5	17.2	17.7	18.3
B3. Exports	6.0	14.1	28.5	29.4	29.9	30.5	31.0	31.3	31.7	31.7	31.3
B4. Other flows 2/	6.0	15.2	24.7	25.5	26.0	26.5	26.9	27.2	27.6	27.4	27.2
B6. One-time 30 percent nominal depreciation	6.0	8.9	7.8	9.4	10.6	11.9	13.1	14.1	15.1	16.0	17.1
B6. Combination of B1-B5	6.0	15.4	20.6	21.7	22.4	23.2	23.9	24.4	25.0	25.1	25.2
<b>C. Tailored Tests</b>											
C1. Combined contingent liabilities	6.0	9.6	11.3	12.5	13.3	14.2	15.0	15.7	16.4	17.0	17.7
C2. Natural disaster	6.0	13.3	15.5	17.0	18.1	19.3	20.4	21.3	22.3	23.1	24.1
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Threshold</b>	<b>30</b>	<b>30</b>	<b>30</b>	<b>30</b>	<b>30</b>	<b>30</b>	<b>30</b>	<b>30</b>	<b>30</b>	<b>30</b>	<b>30</b>
<b>PV of debt-to-exports ratio</b>											
<b>Baseline</b>	13.3	15.7	19.4	23.3	26.4	28.4	27.9	31.5	34.0	36.7	39.5
<b>A. Alternative Scenarios</b>											
A1. Key variables at their historical averages in 185-2628 1/	13.3	11.9	11.3	12.7	13.0	13.8	13.2	14.0	13.9	13.8	13.7
<b>B. Bound Tests</b>											
B1. Real GDP growth	13.3	15.7	19.4	23.3	26.4	28.4	27.9	31.5	34.0	36.7	39.5
B2. Primary balance	13.3	19.4	27.0	31.4	34.7	36.5	35.2	39.0	41.7	44.3	47.0
B3. Exports	13.3	38.2	97.0	105.1	111.4	112.3	104.4	112.2	116.3	119.7	121.2
B4. Other flows 2/	13.3	33.8	55.6	60.3	63.9	64.5	59.9	64.5	66.9	68.6	69.5
B6. One-time 30 percent nominal depreciation	13.3	15.7	13.9	17.7	20.7	23.0	23.1	26.5	29.1	31.8	34.9
B6. Combination of B1-B5	13.3	35.8	41.3	58.9	63.4	64.8	61.0	66.4	69.5	72.0	74.1
<b>C. Tailored Tests</b>											
C1. Combined contingent liabilities	13.3	21.4	25.3	29.5	32.7	34.6	33.5	37.2	39.8	42.6	45.4
C2. Natural disaster	13.3	30.9	36.4	42.0	46.6	49.1	47.5	52.8	56.5	60.4	64.4
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Threshold</b>	<b>140</b>	<b>140</b>	<b>140</b>	<b>140</b>	<b>140</b>	<b>140</b>	<b>140</b>	<b>140</b>	<b>140</b>	<b>140</b>	<b>140</b>
<b>Debt service-to-exports ratio</b>											
<b>Baseline</b>	1.4	1.3	0.8	1.1	1.2	1.1	1.2	1.4	1.5	1.6	1.8
<b>A. Alternative Scenarios</b>											
A1. Key variables at their historical averages in 185-2628 1/	1.4	1.2	0.6	0.9	0.9	0.8	0.8	0.9	1.0	0.9	0.8
<b>B. Bound Tests</b>											
B1. Real GDP growth	1.4	1.3	0.8	1.1	1.2	1.1	1.2	1.4	1.5	1.6	1.8
B2. Primary balance	1.4	1.3	0.8	1.3	1.4	1.3	1.3	1.5	1.7	2.0	2.3
B3. Exports	1.4	1.7	1.8	3.4	3.5	3.3	3.1	3.5	3.7	5.0	7.1
B4. Other flows 2/	1.4	1.3	1.2	1.9	2.0	1.9	1.8	2.0	2.2	3.1	4.1
B6. One-time 30 percent nominal depreciation	1.4	1.3	0.8	1.0	1.1	1.0	1.1	1.3	1.4	1.5	1.4
B6. Combination of B1-B5	1.4	1.5	1.4	2.1	2.2	2.0	2.0	2.3	2.5	3.6	4.1
<b>C. Tailored Tests</b>											
C1. Combined contingent liabilities	1.4	1.3	0.9	1.3	1.3	1.3	1.3	1.5	1.6	1.7	1.9
C2. Natural disaster	1.4	1.4	1.1	1.5	1.6	1.6	1.6	1.8	2.0	2.1	2.3
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Threshold</b>	<b>10</b>	<b>10</b>	<b>10</b>	<b>10</b>	<b>10</b>	<b>10</b>	<b>10</b>	<b>10</b>	<b>10</b>	<b>10</b>	<b>10</b>
<b>Debt service-to-revenue ratio</b>											
<b>Baseline</b>	2.0	1.8	1.1	1.5	1.5	1.5	1.7	1.9	2.0	2.1	2.2
<b>A. Alternative Scenarios</b>											
A1. Key variables at their historical averages in 185-2628 1/	2.0	1.7	0.9	1.2	1.1	1.0	1.1	1.2	1.3	1.1	1.0
<b>B. Bound Tests</b>											
B1. Real GDP growth	2.0	1.9	1.2	1.7	1.8	1.7	1.9	2.1	2.3	2.4	2.6
B2. Primary balance	2.0	1.8	1.2	1.7	1.8	1.7	1.9	2.1	2.2	2.5	2.9
B3. Exports	2.0	1.9	1.7	3.0	2.9	2.8	3.0	3.1	3.3	4.2	5.9
B4. Other flows 2/	2.0	1.8	1.6	2.6	2.6	2.5	2.6	2.7	2.8	4.0	5.1
B6. One-time 30 percent nominal depreciation	2.0	2.3	1.3	1.7	1.7	1.7	1.9	2.2	2.4	2.5	2.2
B6. Combination of B1-B5	2.0	1.9	1.7	2.4	2.4	2.3	2.5	2.7	2.8	4.0	4.5
<b>C. Tailored Tests</b>											
C1. Combined contingent liabilities	2.0	1.8	1.2	1.7	1.7	1.6	1.8	2.0	2.2	2.2	2.4
C2. Natural disaster	2.0	1.8	1.5	1.9	2.0	1.9	2.1	2.3	2.5	2.6	2.7
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Threshold</b>	<b>14</b>	<b>14</b>	<b>14</b>	<b>14</b>	<b>14</b>	<b>14</b>	<b>14</b>	<b>14</b>	<b>14</b>	<b>14</b>	<b>14</b>

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Includes official and private transfers and FDI.

Table 4. Solomon Islands: Sensitivity Analysis for Key Indicators of Public Debt 2018–28

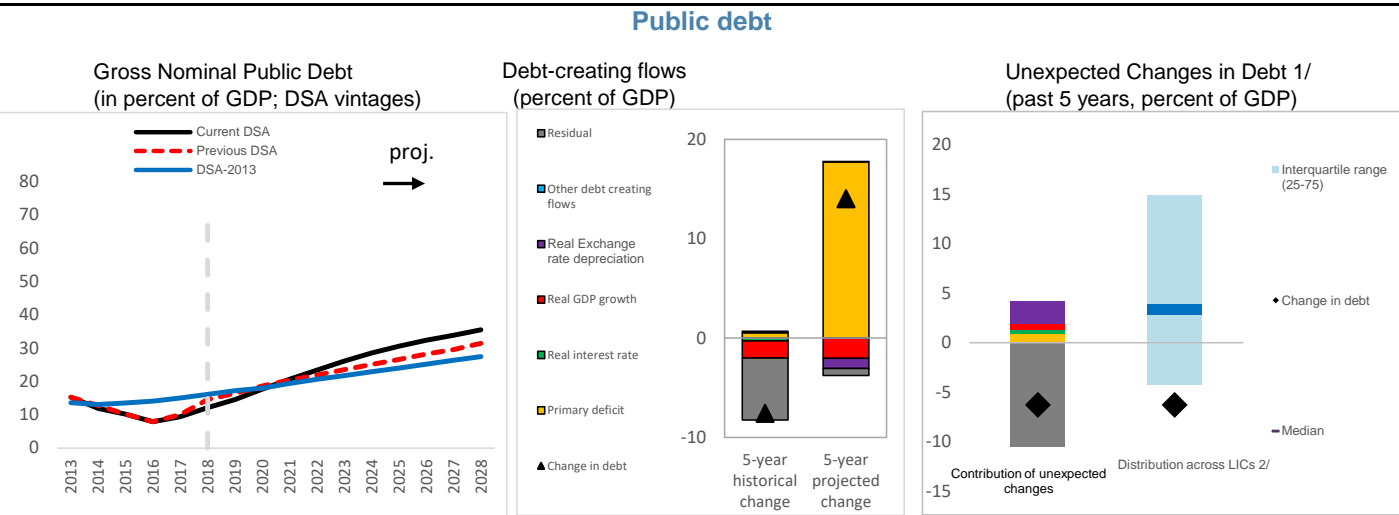
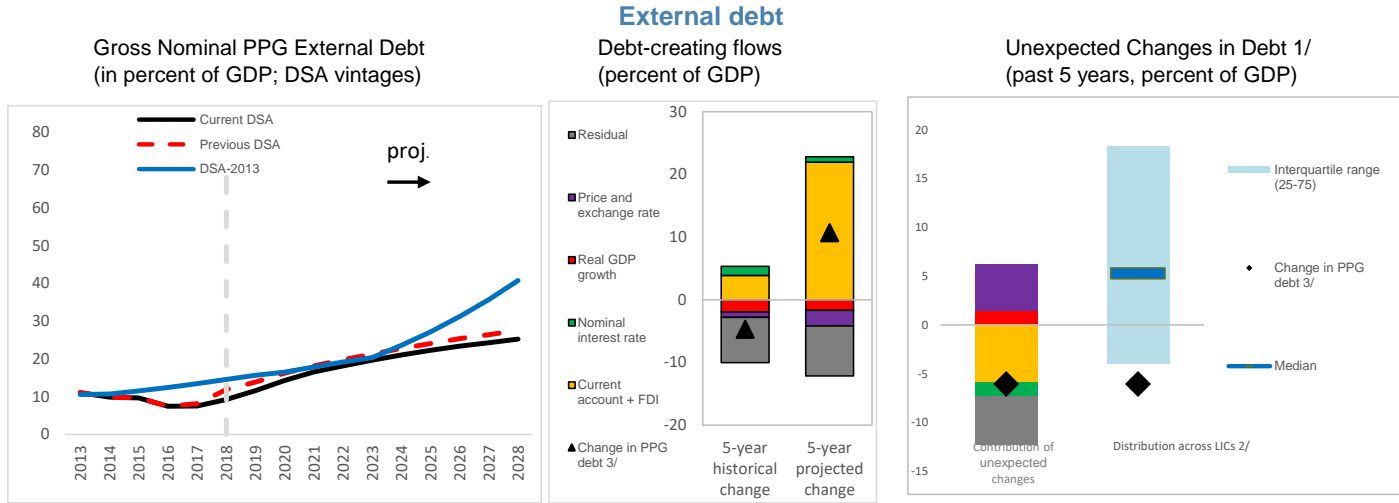
	Projections										
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
<b>PV of Debt-to-GDP Ratio</b>											
<b>Baseline</b>	<b>8.8</b>	<b>10.0</b>	<b>11.9</b>	<b>13.9</b>	<b>15.9</b>	<b>18.1</b>	<b>20.0</b>	<b>21.5</b>	<b>23.0</b>	<b>24.2</b>	<b>25.6</b>
<b>A. Alternative Scenarios</b>											
A1. Key variables at their historical averages in 185-2628 1/	9	7	5	4	2	1	0	-1	-2	-3	-4
<b>B. Bound Tests</b>											
B1. Real GDP growth	9	12	19	24	29	35	40	44	48	52	56
B2. Primary balance	9	13	17	19	21	23	24	26	27	28	29
B3. Exports	9	16	28	30	31	33	35	36	37	37	38
B4. Other flows 2/	9	18	28	30	31	33	34	35	37	37	37
B6. One-time 30 percent nominal depreciation	9	10	9	10	10	11	11	11	11	11	11
B6. Combination of B1-B5	9	12	14	14	16	18	20	21	23	24	25
<b>C. Tailored Tests</b>											
C1. Combined contingent liabilities	9	14	16	18	19	22	23	25	26	27	28
C2. Natural disaster	9	20	22	24	27	29	31	33	35	36	37
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Public debt benchmark</b>	<b>35</b>	<b>35</b>	<b>35</b>	<b>35</b>	<b>35</b>	<b>35</b>	<b>35</b>	<b>35</b>	<b>35</b>	<b>35</b>	<b>35</b>
<b>PV of Debt-to-Revenue Ratio</b>											
<b>Baseline</b>	<b>20.4</b>	<b>23.3</b>	<b>27.9</b>	<b>33.0</b>	<b>37.8</b>	<b>43.4</b>	<b>47.9</b>	<b>51.6</b>	<b>55.3</b>	<b>58.6</b>	<b>62.4</b>
<b>A. Alternative Scenarios</b>											
A1. Key variables at their historical averages in 185-2628 1/	20	16	12	9	5	3	0	-3	-5	-8	-10
<b>B. Bound Tests</b>											
B1. Real GDP growth	20	28	42	55	67	80	91	101	112	121	131
B2. Primary balance	20	30	40	45	49	54	58	62	65	68	71
B3. Exports	20	37	66	71	75	79	83	86	89	90	92
B4. Other flows 2/	20	42	66	70	74	79	82	85	88	89	91
B6. One-time 30 percent nominal depreciation	20	24	23	23	24	26	27	27	27	27	28
B6. Combination of B1-B5	20	28	32	33	37	43	47	51	54	57	61
<b>C. Tailored Tests</b>											
C1. Combined contingent liabilities	20	33	37	42	46	51	56	59	62	65	69
C2. Natural disaster	20	47	52	58	63	69	74	78	83	86	91
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Debt Service-to-Revenue Ratio</b>											
<b>Baseline</b>	<b>2.6</b>	<b>2.4</b>	<b>2.5</b>	<b>3.9</b>	<b>6.0</b>	<b>5.9</b>	<b>6.1</b>	<b>6.2</b>	<b>6.3</b>	<b>6.3</b>	<b>6.3</b>
<b>A. Alternative Scenarios</b>											
A1. Key variables at their historical averages in 185-2628 1/	3	2	2	3	5	5	5	4	4	4	3
<b>B. Bound Tests</b>											
B1. Real GDP growth	3	2	3	5	8	8	9	9	9	10	10
B2. Primary balance	3	2	3	5	6	6	7	7	7	7	7
B3. Exports	3	2	3	5	7	7	7	7	7	8	9
B4. Other flows 2/	3	2	3	5	7	7	7	7	7	8	9
B6. One-time 30 percent nominal depreciation	3	2	3	4	6	6	6	6	6	6	5
B6. Combination of B1-B5	3	2	2	4	6	6	6	6	6	6	6
<b>C. Tailored Tests</b>											
C1. Combined contingent liabilities	3	2	4	4	6	6	6	6	7	7	7
C2. Natural disaster	3	2	5	5	7	7	7	7	7	7	7
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.

2/ Includes official and private transfers and FDI.

**Figure 3. Solomon Islands: Drivers of Debt Dynamics – Baseline Scenario**



1/ Difference between anticipated and actual contributions on debt ratios.

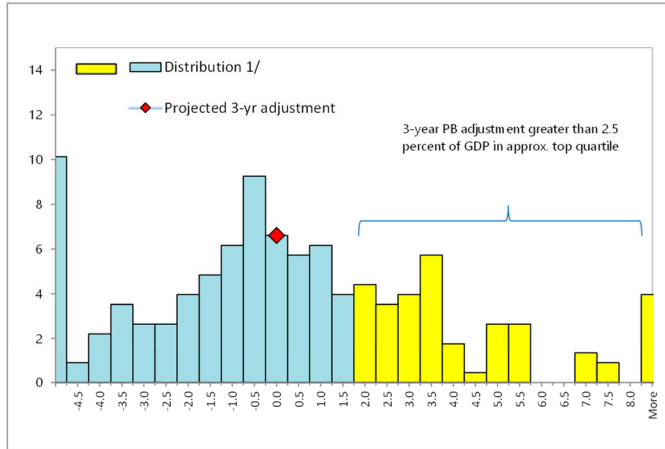
2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.



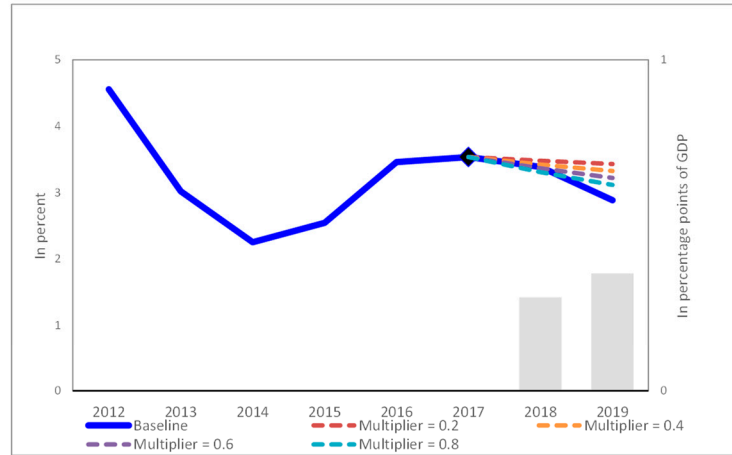
Figure 4. Solomon Islands: Realism Tools

3-Year Adjustment in Primary Balance(Percentage points of GDP)



1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

**Figure 5. Solomon Islands: Qualification of the Moderate Category, 2018–28 1/**



Sources: Country authorities; and staff estimates and projections.

1/ For the PV debt/GDP and PV debt/exports thresholds, x is 20 percent and y is 40 percent. For debt service/Exports and debt service/revenue thresholds, x is 12 percent and y is 35 percent.

**Statement by Mr. Johnston, Alternate Executive Director, and Mr. Kikiolo, Advisor  
to the Executive Director on Solomon Islands  
October 29, 2018**

Solomon Islands is a low-income country of around 600,000 people speaking many different languages across hundreds of islands in the Pacific. Its dispersed population, large infrastructure needs, narrow economic base, and exposure to natural disasters and commodity price volatilities pose many development challenges. The authorities are aware of the macroeconomic risks the country faces and appreciate the analysis, advice and technical assistance provided by the Fund.

**Economic outlook**

Robust growth is being driven by the logging and palm oil sectors, supported by the fishing, construction, wholesale and retail, and transport and storage sectors. Inflation remains within the expected range of 2 to 4 percent. The first six months of 2018 saw a current account surplus, but this is expected to reverse over the second half of the year and widen in future years because of capital goods imports from major projects. Foreign reserves are equivalent to 11.8 months of imports and are likely to decline moderately in the future.

The Solomon Island authorities are more optimistic about growth prospects than staff, in part because they assume logging activity will hold up for longer. In addition, reopening of the Gold Ridge Mine and major infrastructure projects will support growth in the next few years. These projects—including the undersea cable and Tina River Hydro Project—will also help lower the cost of doing business and improve productivity over the long term. Diversification is a challenge, but there is scope to promote activity in the non-logging sector. An inter-agency sustainable taskforce has been established to help steer the economy away from its overdependence on logging and initial measures include a reduction in logging licenses and changes to the tax regime. A policy is also being developed to encourage downstream processing of some of the harvested log volumes.

**Fiscal policy**

Stabilizing public finances has been a priority of the government since its formation in 2017, and this will be a gradual process over many years. The government's clearance of most, if not all, of the 2017 arrears has been an important step. To contain the deficit, large spending cuts were made in the 2018 Budget, although many of these cuts reflected underspends across government ministries in prior years due to capacity constraints. Priority infrastructure projects were protected. The authorities welcomed a Fund technical assistance report on strengthening the fundamentals of public financial management. The recent appointment of an Accountant-General, a position unfilled since

2016, will help address issues highlighted in the TA report, including problems with cash management.

The authorities welcomed the debt sustainability analysis that assesses Solomon Islands at moderate risk of debt distress. Noting the large infrastructure financing gaps of the country, the authorities raised the public debt threshold from 30 percent of GDP to 35 percent to allow borrowing for future capital investment needs. The authorities remain committed to ensure future borrowings are affordable and in line with the spirit of the debt management framework. Currently, public debt stands at 11 percent of GDP.

### **Monetary and financial sector policies**

The Central Bank of Solomon Islands has announced it will continue its accommodative monetary policy in view of the low inflation environment, weak credit growth and subdued aggregate demand. There is structural excess liquidity in the banking system but no urgency in mopping this up, as lending remains subdued and poses little threat to inflation.

There is also a cost in issuing more paper in the under-developed domestic market. In fact, the authorities hope commercial banks lend more to businesses to help boost private sector activities and employment. However, they are prepared to take remedial action if credit growth threatens price stability.

Banks are well-capitalized and profitable, in a shallow and under-developed market. High interest rate spreads reflect downward stickiness in commercial banks' lending rates despite notable improvements in the country's economic and risk conditions. Pressure to regulate interest rates is growing from businesses and politicians but the authorities are reluctant to intervene. NPLs have improved in 2018 to 5.8 percent of gross loans because of recovery actions by banks. The main bank serving the logging industry is currently without a correspondent banking relationship and is being assisted by the Central Bank through a temporary arrangement with the Federal Reserve Bank that expires at the end of the year. The bank in question is addressing issues identified by a potential correspondent and is on track to have a relationship established in January next year.

Work is continuing under the National Financial Inclusion Strategy 2016-2020. The Solomon Islands National Provident Fund Act has been amended to allow the rollout of the 'youSave' scheme that lets informal and self-employed people join the superannuation scheme. Recognizing that basic financial literacy is low throughout the country, the authorities are working to mainstream financial literacy in the school curriculum.

## **Governance issues**

The authorities share many of the governance concerns raised by the mission team and recognize that this is an area where more work needs to be done, drawing on technical assistance from the Fund, amongst others. Legislation has already been passed to promote good governance, despite a difficult political environment. This includes the Anti-Corruption Act, Whistleblowers Act and Ombudsman Act. While development spending was cut back strongly in the 2018 Budget to help the fiscal position, it is worth noting that discretionary funds managed by Members of Parliament—including shipping grants, scholarship grants, church grants and rural constituency development funds—were also cut by 35 percent. The authorities note staff’s recommendations to strengthen public investment management and welcome technical assistance to develop the country’s capacity in this area.