INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/57

# SOLOMON ISLANDS

March 2018

## 2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR 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 2017 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 February 16, 2018 consideration of the staff report that concluded the Article IV consultation with Solomon Islands.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 16, 2018, following discussions that ended on September 28, 2017, with the officials of Solomon Islands on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 4, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staff of the IMF and the International Development Association.
- A **Statement by the Executive Director** for Solomon Islands.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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

Press Release No. 18/72
FOR IMMEDIATE RELEASE
March 5, 2018

International Monetary Fund
700 19th Street, NW
Washington, D.C. 20431 USA

**IMF Executive Board Concludes 2017 Article IV Consultation with Solomon Islands**

On February 16, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the 2017 Article IV Consultation with Solomon Islands.[1]

The Solomon Islands economy grew by 3.5 percent in 2016 driven by a peak in the forestry sector. Growth remained solid in 2017 and is projected at 3.0 for 2018, buoyed by infrastructure spending, fisheries and agriculture, although logging production is slowing down. Inflation is contained at an annual rate of just 1.6 percent in October 2017. The current account deficit has widened a little but international reserves levels are comfortable.

Monetary conditions are accommodative with interest rates below their long-term average. The issuance of Bokolo bills to mop up excess liquidity remains high. Credit growth has moderated from an average of around 15 percent over 2013–2016 to around 10 percent in August 2017.

The fiscal deficit is expected to have reached 4.0 percent of GDP in 2017 and to widen further in 2018. Public debt is picking up from a low level. The risks to the economy are on the downside with the weakening fiscal position heightening vulnerability to shocks.

Solomon Islands faces large medium-term development challenges. Infrastructure needs are large, particularly with regard to energy supply, transportation, and telecommunications.

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

**Executive Board Assessment**[2]

Executive Directors welcomed the recent solid growth performance, low inflation and comfortable external reserves position. However, as the fiscal position has weakened, depleting buffers and leading to an accumulation of domestic payment arrears, Directors encouraged the authorities to take timely actions to place the fiscal position on a firmer footing. Directors also noted that Solomon Islands faces long term development challenges, including from natural disasters and climate change.

Directors highlighted the need to strengthen fiscal discipline and improve the quality of public spending. They underscored the importance of tackling domestic arrears, gradually rebuilding cash reserves, and better prioritizing spending. Moreover, Directors encouraged the authorities to consider adopting an operational fiscal target to guide annual budgets. They also underscored the need to balance the pace of borrowing for critical infrastructure against debt sustainability, absorptive capacity and domestic market development.

Directors urged sustained fiscal reform efforts and commended the recently launched tax review. They highlighted the importance of introducing a Medium-Term Fiscal Strategy to assess tradeoffs between development spending and building buffers, including for disaster risk reduction. Directors called for sustained efforts to enhance the transparency of Constituency Development Funds, strengthen revenue compliance, improve the legal framework, and strengthen the AML/CFT framework, to foster anti-corruption efforts.

Directors considered the current monetary policy stance and the exchange rate peg broadly appropriate. However, the central bank can gradually increase the cash reserve requirement to absorb structural excess liquidity. Directors encouraged the authorities to periodically reassess the level of the exchange rate to ensure that it remains supportive of external stability and economic growth.

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

Director commended efforts to enhance financial inclusion and strengthen the financial sector. To this end, there is a need to clear the backlog of financial legislation including the new Financial Institutions Act, the Credit Unions Act, and National Provident Fund Act, and to strengthen the financial sector supervisory and regulatory frameworks.

Directors underlined the need to diversify the economy, generate new sources of growth and strengthen resilience. They emphasized the importance of achieving the objectives of the National Development Strategy, including significant investment in infrastructure, and legislative and policy reforms. Reforms are also needed to foster private sector development and improve the business environment.

## Table 1. Solomon Islands: Selected Economic Indicators 2013–19

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

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|
| | | | | Est. | Proj. | Proj. | Proj. |
| **Growth and Prices** | Annual percentage change unless otherwise indicated | | | | | | |
| Real GDP | 3.0 | 2.3 | 2.5 | 3.5 | 3.2 | 3.0 | 2.9 |
| CPI (period average) | 5.4 | 5.2 | -0.6 | 0.5 | 1.0 | 1.3 | 2.0 |
| GDP deflator | 2.3 | 2.5 | 3.1 | 3.6 | 1.6 | 2.7 | 3.2 |
| Nominal GDP (in SI$ millions) | 8,250 | 8,646 | 9,139 | 9,798 | 10,28 | 10,884 | 11,56 |
| **Central Government Operations** | In percent of GDP | | | | | | |
| Total revenue and grants | 50.9 | 47.3 | 47.9 | 41.2 | 41.2 | 42.4 | 42.0 |
| Revenue | 33.5 | 32.8 | 35.1 | 31.7 | 31.7 | 31.5 | 31.4 |
| Grants | 17.5 | 14.5 | 12.9 | 9.5 | 9.5 | 10.8 | 10.6 |
| Total expenditure | 46.8 | 45.6 | 48.2 | 44.5 | 45.3 | 48.1 | 45.8 |
| excluding grant-funded expenditure | 29.4 | 31.1 | 35.3 | 35.0 | 35.7 | 37.2 | 35.3 |
| Recurrent expenditure | 33.8 | 32.6 | 33.7 | 30.4 | 30.4 | 31.0 | 31.0 |
| Development expenditure | 16.2 | 12.6 | 14.3 | 14.7 | 14.9 | 17.1 | 14.9 |
| Unrecorded expenditure 1/ | -3.1 | 0.4 | 0.2 | -0.6 | 0.0 | 0.0 | 0.0 |
| Overall balance | 4.1 | 1.7 | -0.2 | -3.3 | -4.1 | -5.7 | -3.9 |
| Foreign financing (net) | -0.6 | -0.5 | -0.2 | 0.3 | 0.1 | 4.2 | 2.7 |
| Domestic financing (net) | -3.5 | -1.2 | 0.4 | 3.0 | 4.0 | 1.5 | 1.1 |
| Central government debt 1/ | 15.3 | 12.8 | 10.1 | 7.9 | 10.0 | 14.6 | 16.4 |
| Domestic debt | 4.2 | 2.9 | 0.5 | 0.4 | 1.8 | 2.7 | 2.5 |
| Of which: principal arrears | | | | | | | |
| External debt | 11.1 | 9.9 | 9.7 | 7.5 | 8.2 | 11.9 | 13.9 |
| **Macrofinancial** | Annual percentage change (end of year) | | | | | | |
| Credit to private sector | 15.1 | 16.4 | 16.7 | 12.1 | 8.0 | 8.0 | 7.5 |
| Broad money | 12.4 | 5.6 | 15.0 | 13.4 | 10.1 | 11.9 | 5.3 |
| Reserve money | 3.0 | -10.1 | 23.5 | 14.5 | 9.0 | 6.7 | 5.3 |
| Deposit accounts with commercial banks per 1,000 | 251.8 | 454.3 | 487.5 | 526.2 | … | … | … |
| Loan accounts with commercial banks per 1,000 adults | 36.1 | 40.1 | 39.4 | 31.2 | | | |
| **Balance of Payments** | In US$ millions unless otherwise indicated | | | | | | |
| Trade balance | -139.0 | -116.7 | -93.5 | -71.6 | -84.5 | -115.0 | - |
| (percent of GDP) | -12.3 | -9.9 | -8.1 | -5.8 | -6.6 | -8.3 | -10.1 |
| Current account balance | -38.5 | -50.1 | -35.2 | -48.7 | -56.1 | -68.5 | -92.9 |
| (percent of GDP) | -3.4 | -4.3 | -3.0 | -3.9 | -4.4 | -5.0 | -6.4 |
| Foreign direct investment | 50.4 | 20.3 | 27.6 | 36.0 | 58.6 | 34.8 | 52.9 |
| (percent of GDP) | 4.5 | 1.7 | 2.4 | 2.9 | 4.6 | 2.5 | 3.6 |
| Overall balance | 31.6 | -16.2 | 53.0 | 2.2 | -10.7 | 24.3 | 0.4 |
| Gross official reserves (in US$ millions, end of period) 2/ | 531.2 | 514.3 | 519.6 | 513.6 | 569.0 | 589.9 | 588.3 |
| (in months of next year's imports of GNFS) | 9.3 | 10.0 | 10.0 | 9.5 | 9.7 | 9.2 | 8.7 |
| Net official reserves (in US$ millions, end of period) | 511.5 | 496.2 | 505.6 | 503.5 | 561.0 | 585.3 | 585.8 |
| (in months of next year's imports of GNFS) | 9.0 | 9.6 | 9.7 | 9.3 | 9.6 | 9.1 | 8.7 |
| **Exchange Rate** (SI$/US$, end of period) 3/ | 7.4 | 7.4 | 8.1 | 7.8 | ... | ... | ... |
| Real effective exchange rate (end of period, 2005 = 100) 3/ | 135.1 | 144.7 | 154.3 | 153.2 | … | … | … |
| **Memorandum Items:** | | | | | | | |
| Cash balance (in SI$ millions) | 608 | 880 | 694 | 412 | 154 | 87 | -44 |
| in months of recurrent spending | 3.7 | 5.1 | 3.6 | 2.0 | 0.7 | 0.4 | -0.1 |
| SIG Deposit Account (MEFP Table 2; monitored under | 140 | 140 | 140 | 140 | 140 | 140 | 140 |
| Broader cash balance (=Cash balance+SIG Deposit | 748 | 1,020 | 834 | 552 | 294 | 227 | 96 |
| in months of total spending 4/ | 3.7 | 4.6 | 3.1 | 1.9 | 1.0 | 0.7 | 0.3 |

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/ The 2016 numbers refer to June.
4/ Total spending is defined as total expenditure, excluding grant-funded expenditure.

INTERNATIONAL MONETARY FUND

# SOLOMON ISLANDS

## STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

January 4, 2018

## KEY ISSUES

**Context.** Solomon Islands has made considerable gains in establishing macroeconomic stability and strengthening institutions in the past six years. The Australia-led Regional Assistance Mission to Solomon Islands (RAMSI) withdrew this year after fourteen years, having succeeded, together with the authorities, in restoring law and order and re-establishing public institutions. However, Solomon Islands faces numerous challenges common to many small states in the Pacific— it is remote, highly vulnerable to natural disasters and climate change, has a narrow production base, a large infrastructure gap, and administrative capacity constraints. The government is gearing up for elections in early 2019 and the fiscal position has deteriorated.

**Article IV Consultation**. The consultation focused on steps to place the fiscal position on a firmer footing and build resilience. Medium-term goals include generating new sources of growth and achieving the Sustainable Development Goals.

**Key policy recommendations**:

- Enhance resilience to shocks by rebuilding fiscal buffers to an adequate level and adopting a clear fiscal anchor to guide annual budgets, maintain fiscal discipline, and provide flexibility in responding to shocks.
- Implement measures to enhance revenues and prioritize spending by strengthening tax compliance, streamlining exemptions, and improving the transparency and prioritization of spending.
- Strengthen the medium term fiscal framework to ensure fiscal sustainability and advance public financial management reforms.
- Continue implementing the currency basket peg exchange rate regime with annual reviews to keep the peg in line with underlying conditions. While the monetary stance is appropriate, a gradual increase in the cash reserve requirement should be considered to absorb structural excess liquidity.
- Complete outstanding financial sector reforms began under the Fund-supported program, which ended in March 2016.

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

Discussions took place in Honiara during September 19–28, 2017. The staff comprised of Ms. Alison Stuart (head), Messrs. Nishizawa (APD), Didenko (FAD), and Ms. Singh (Res Rep Office Fiji). Ms. Barron and Ms. Preston (both OED) joined the policy discussions. Mr. Neves (PFTAC) attended technical meetings. Ms. Kaendera (APD) and Mr. Jamaludin (RMU) contributed from headquarters. The mission met with former Deputy Prime Minister Manasseh Maelanga, former Minister of Finance Mr. Snyder Rini, Central Bank Governor Denton Rarawa, and other government officials, donors, the private sector, Transparency Solomon Islands and CSOs. Ms. Zhang and Ms. Ibrahim provided excellent research and editorial assistance for this report.

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## APPENDICES

# CONTEXT

### *A small fragile state with multiple challenges*

**1. Solomon Islands faces numerous problems common to Pacific islands.**

- The economy has a narrow production base reliant on logging, it is geographically-dispersed, remote, with capacity constraints, vulnerability to natural disasters and climate change, has a large infrastructure gap, and is highly dependent on aid and imports (Figure 1).
- Solomon Islands is ranked the fourth most vulnerable country to natural disasters among the Pacific islands. In any year, there is a 14 percent probability of a natural disaster affecting more than 5 percent of the population or inflicting damage/loss of more than 3 percent of GDP. In its worst natural disaster, more than half of the population was affected and damage/loss reached 14 percent of GDP. Natural disasters weigh on potential growth.
- The economy is also vulnerable due to political fragility and fiscal slippage.

**2. The have been episodes of political instability.** In 1998 clashes between ethnic groups over control of resources led to "The Tensions" which ended following the 2003 arrival of an Australia-led international security force—the Regional Assistance Mission to Solomon Islands (RAMSI). On June 30, 2017, RAMSI withdrew, having succeeded, together with the authorities, in restoring law and order and re-establishing public institutions (Box 1). Fluid political alliances result in frequent changes in government. In November 2017, the Prime Minister was replaced following a vote of no confidence. The current coalition faces elections by early 2019.

#### Box 1. Achievements of RAMSI 2003–17

RAMSI assisted Solomon Islands in reestablishing stability after "The Tensions" through a joint peacekeeping and nation rebuilding mission. Alongside investment in security operations, RAMSI focused on reviving the economy, building inclusive civic institutions, establishing financial infrastructure, a justice system, and restoring public health and education services.

Early successes included stabilizing government finances and normalizing debt, as well as helping the government to carry out economic reforms, including a Public Financial Management Act, debt management framework, and a Central Bank Act. The focus later shifted to capacity building, though progress is slow due to skills gaps. Land rights grievances, an underlying cause of the tensions, and corruption have yet to be fully resolved. Development partners' support is important to sustain progress.

**3. IMF-supported programs were successful in supporting the authorities' reform agenda but reforms have stalled recently.** A program in 2010 was followed by an ECF, which successfully concluded in March 2016. The programs helped build policy buffers, macroeconomic management capacity and institutions. Subsequently, with rising spending and revenues falling short of target, the fiscal position has deteriorated. Restraining fiscal spending will be difficult ahead of the elections.

**4. Medium-term challenges include generating new sources of growth and achieving the Sustainable Development Goals (SDGs).** Only 28 percent of indicators in the National Development Strategy (NDS) 2011–20 registered progress by 2015. The new NDS 2016–35 identifies tourism, fisheries, and agriculture as sectors for development. It sets five development goals—sustained and inclusive growth, poverty alleviation, access to social services, sustainable environmental development, and stable effective governance/public order (Appendix I). Progress on the new NDS has been slow. On the positive side, good progress has been made on Tina River Hydro project which will reduce reliance on diesel imports (Box 2). Key impediments to development include the slow pace of legislative and policy reforms, land tenure, and security and governance.

### Box 2. Tina River Hydropower Development Project (TRHDP)

**Solomon Islands' first large energy project aims to reduce electricity costs—among the highest in the world—and reduce reliance on diesel imports.** It leads efforts to diversify electricity generation in favor of clean, renewable sources such as hydro and solar power. It has the potential to more than cut in half annual greenhouse gas emissions. The project is supported by development partners including the Green Climate Fund (GCF). The project will be completed over 2018–22.

**Financing Scheme**

(In millions of US dollar)

| | Total | Loan | Grant |
|---|---|---|---|
| GCF | 86.0 | 70.0 | 16.0 |
| WB/IDA | 33.6 | 24.7 | 8.9 |
| ADB | 30.0 | 18.0 | 12.0 |
| IRENA/ADFD | 15.0 | 15.0 | |
| EDCF | 31.6 | 31.6 | |
| Australia | 11.7 | | 11.7 |
| Total | 207.9 | 159.3 | 48.6 |

Source: Consideration of funding proposals - Addendum VII, Green Climate Fund.

# RECENT DEVELOPMENTS

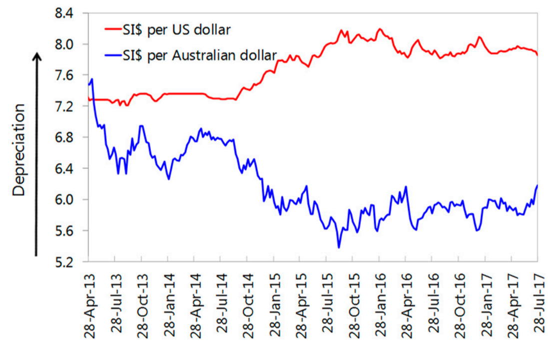
***Macro-conditions are favorable but fiscal buffers are depleted.***

**5. Economic activity is solid and inflation is contained.** Real GDP growth reached 3.5 percent in 2016 with record logging production (Figure 2, Table 1). A loosening of regulations allowed expansion into designated timber reserve areas and low export-duty benchmark prices boosted activity. Cash crops, fishing revenues, and construction also supported growth. In 2017 forestry activity has fallen back but agriculture and construction remain robust. The annual inflation rate was just 1.6 percent in October 2017.

**6. The current account deficit widened a little in 2016 but international reserve levels are comfortable.** The 2016 current account deficit (CAD) widened to 3.9 percent of GDP as gains from a stronger trade balance—due to higher logging exports and improved terms of trade—were offset by higher dividend payments on FDI. Net international reserves stood at around US$557 million in November 2017, 9.5 months import cover, and above reserve adequacy benchmarks. Following a loss in competitiveness in recent years, the REER stabilized in 2016–17, with greater movement of the basket peg against the U.S. dollar (paragraph 26), a steadier U.S. dollar, and favorable inflation differentials.

**Volatility against the Australian dollar is lower...**

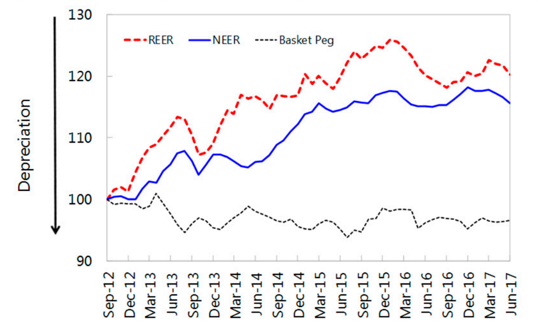
**Solomon Islands: Bilateral Nominal Exchange Rates**




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

**... the real exchange rate has stabilized.**

**Solomon Islands: Effective Exchange Rate and Basket Peg**
(Index Sept-2012=100) (Solomon Island dollar per U.S. dollar)




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

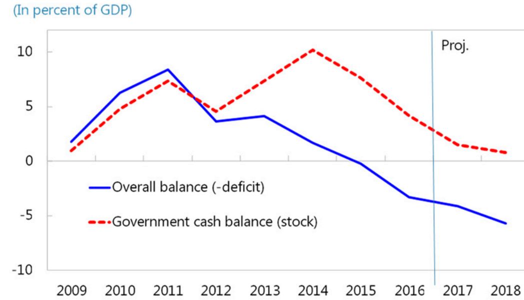
**7. Fiscal discipline has slipped and the setting is challenging.** The deficit widened to 3.3 percent of GDP in 2016 as lower revenues and grants were not matched by expenditure restraint (Figure 3, Table 2).

- *Revenues:* lower goods tax collection and income and profits tax more-than-offset higher-than-expected export duties and fishing license fees.
- *Expenditures excluding grants:* fell by 0.3 percentage points but this was less than the decline in grants. Recurrent expenditure remained high. Constituency Development Funds (CDFs)—transfers to electoral constituencies for rural development—have doubled since 2013 and amounted to 3.3 percent of GDP.
- *Grants:* were 3.4 percent of GDP down reflecting the completion of several donor-assisted projects, a delay in the disbursement of EU budget support, and lower grants in anticipation of RAMSI's departure.

**8. Fiscal buffers have substantially eroded.** With revenues not meeting overly optimistic expectations, the Supplementary Budget now projects a large deficit for 2017. The *narrow* cash balance fell from 3.6 months of recurrent spending at end-2015 to 2.0 months at end-2016 and further to 1.7 months in July 2017.[1] The *broader* cash balance also declined.[2]

**The fiscal position has deteriorated**

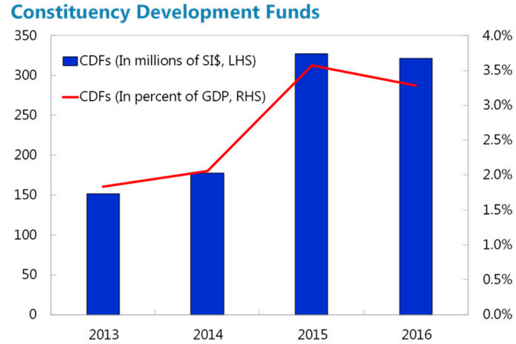
**Fiscal Balance**
(In percent of GDP)




Sources: Country authorities and IMF staff estimates.

**CDF spending is high**

**Constituency Development Funds**




Sources: Country authorities and IMF staff estimates.

[1] The narrow cash balance equals the sum of government deposits held at the CBSI and the commercial banks minus unpaid payment orders and unpresented checks.

[2] The 2016 AIV recommended monitoring a *broader* cash balance: the narrow cash balance plus reserves in the government consolidated deposit account (SI$140mn) as a proportion of *total* spending, with a floor of 2 months.

**9. This has led to government payment delays.** Domestic arrears were 1.4 percent of GDP in September, and spending pressure has risen, with an unanticipated increase in tertiary scholarship spending. There have been delays in education allowance payments and government employees' housing rent; moreover, a hiring freeze for nurses and doctors was announced in August.

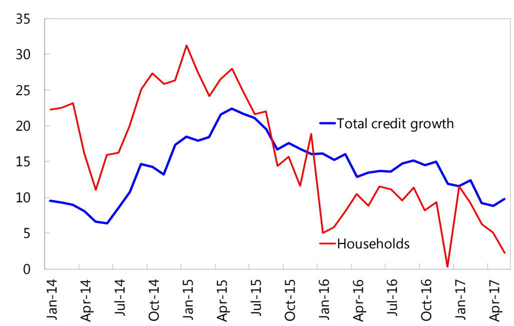
**10. Public debt has picked up from a low to finance infrastructure investment.** Development partners pulled out of financing an undersea fiber-optic cable from Honiara to Sydney as procurement procedures required by development agencies to ensure sound investment allocation were not followed. Instead, the government issued a SI$150 million bond to the National Provident Fund (NPF) to finance this project. Loan guarantees also increased. These raised the level of public and publicly-guaranteed debt from 7.9 percent of GDP at end-2016 to 10 percent of GDP in mid-2017.

**11. Monetary conditions are accommodative but the transmission mechanism is weak.** Commercial banks' structural excess reserves are high, reflecting the accumulation of exports receipts and unsterilized inflows of donor financing. Bokolo bills issuance to mop up excess liquidity is high, but the cash reserve requirement ratio (CRR) is unchanged. Interest rates are below their long-term average and at its latest meeting the Central Bank of Solomon Islands (CBSI) maintained an accommodative policy stance. High spreads of around 10 percent and a low loan to deposit ratio of 60 percent suggest that the transmission mechanism is weak.

**12. Credit growth has moderated.** Credit growth—which averaged 15.5 percent throughout 2013–16—has decelerated to around 10 percent (Figure 4). Following a reassessment of risk and guidance from the CBSI, commercial banks have reined in their exposure to households—housing loans had been a major contributor to credit growth in recent years, emerging as a supervisory concern. In 2017 lending has been channeled to the retail sector, alongside buoyant retail spending, boosted by higher royalty payments from logging activity.

**Credit growth has moderated**

**Total credit and household loan growth**




Sources: Central Bank of Solomon Islands; IMF staff calculations.

**13. Financial soundness indicators (FSIs) do not suggest immediate stability concerns but require close monitoring.** While a thin financial sector means that FSIs can be volatile, in 2017 Q2 capital adequacy, earnings and profitability, and liquidity were comfortably within historical norms, though NPLs have risen each quarter since end-2016 (Text-Table 1). The CBSI inaugural Financial Stability Report highlighted the main supervisory concerns as governance (for non-banks) and government payment delays. While banks can cope with some payment delays, the position would become more fragile if they become protracted.

**Text Table 1. Solomon Islands: Core Financial Soundness Indicators, 2013–17[1]**

| | 2013 | 2014 | 2015 | 2016 | 2017 | |
|---|---|---|---|---|---|---|
| | | | | | Q1 | Q2 |
| Capital Adequacy | | | | | | |
| Regulatory Capital to Risk-Weighted Assets | 32.4 | 31.6 | 31.3 | 32.3 | 33.0 | 32.8 |
| Non-performing Loans Net of Provisions to Capital | 12.0 | 8.1 | 7.3 | 6.6 | 7.4 | 10.0 |
| Asset Quality | | | | | | |
| Non-performing Loans to Total Gross Loans | 7.0 | 4.7 | 4.1 | 3.8 | 4.2 | 5.2 |
| Earnings and Profitability | | | | | | |
| Return on Assets | 4.0 | 3.3 | 3.4 | 3.5 | 3.9 | 4.3 |
| Return on Equity | 23.3 | 20.0 | 20.1 | 22.7 | 23.3 | 25.7 |
| Interest Margin to Gross Income | 54.3 | 56.7 | 54.7 | 56.3 | 56.9 | 55.2 |
| Non-interest Expenses to Gross Income | 52.8 | 51.6 | 51.9 | 47.1 | 45.9 | 43.7 |
| Liquidity | | | | | | |
| Liquid Assets to Total Assets (Liquid Asset Ratio) | 40.6 | 38.0 | 33.5 | 38.1 | 36.0 | 37.6 |
| Liquid Assets to Short Term Liabilities | 56.5 | 51.7 | 46.2 | 53.3 | 50.3 | 55.1 |

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

**14. Buffers have eroded and reforms have slowed.** Of the seven outstanding ECF structural benchmarks, all but one remain outstanding (Text Table 2, Appendix II).

**Text Table 2. Solomon Islands: Policy Buffer Indicators, 2010–17**

| | 2010 (Pre-SCF/ECF) | 2015 (final ECF test-date) | 2016 | 2017 1/ |
|---|---|---|---|---|
| Net international reserves (in next year's imports) | 5.2 | 9.7 | 9.3 | 8.4 |
| Central government debt (in percent of GDP) | 28.5 | 10.1 | 7.9 | 10.0 |
| Program Cash Balance (in months of recurrent spending) 2/ | 2.3 | 3.6 | 2.0 | 0.7 |
| Broader Cash Balance (in months of total spending) 3/ | 3.4 | 3.1 | 1.9 | 1.0 |

1/ Latest available or estimate.
2/ Recurrent spending is defined as total recurrent expenditure, excluding donor-funded recurrent expenditure.
3/ Total spending is defined as total expenditure, excluding donor-funded expenditure.
Red = deterioration and Green = improvement after the conclusion of the ECF.

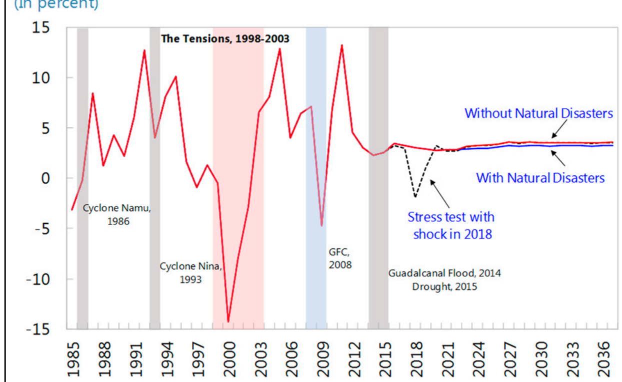
# OUTLOOK, RISKS, AND VULNERABILITIES

**15. Near-term growth is set to be relatively buoyant**. Growth is projected at 3.2 percent in 2017 and 3.0 percent in 2018 buoyed by infrastructure spending, though logging production is expected to gradually decline. The authorities are also looking to push forward the undersea cable project financed by domestic borrowing after the withdrawal of donor financing.

**16. However, the medium-term outlook is uncertain.** Interest in bauxite mining has increased and the Gold Ridge Mine has secured funding for rehabilitation. However, if government payment problems persist this will weigh on growth. Staff's baseline projections assume fiscal problems remain a drag in the near term, while the resumption of mining activity is an upside risk.

- **Real GDP growth** averages 2.9 percent over 2017–22 with infrastructure spending being supportive, logging production flat, and intermittent domestic arrears impinging on activity. The years 2017–22 are assumed to be disaster-free but from 2023 onwards the baseline reflects the average long-term effects of natural disasters by lowering growth, raising imports and increasing the fiscal deficit (see Debt Sustainability Analysis (DSA) document). Without disasters, in the long run, growth gradually rises to 3.5 percent underpinned by infrastructure development and mining (Appendix III) but is scaled down by 0.3pps a year in the projections, to 3.2 percent, to account for natural disasters. A stress test of a severe natural disaster shock is added to the DSA in 2018.

**Real GDP Growth Trajectory**
(In percent)



Sources: IMF staff estimates.

- **Inflation** remains low in 2017 and 2018 and rises over the medium term to 4.0 percent, a little lower than its historical average.

- **The current account deficit** widens to 5–6 percent of GDP over 2017–22 as infrastructure projects (including the TRHDP) have a high import content. Non-oil commodity prices remain low, but rising oil prices could potentially exert pressure on the current account.
- **Fiscal outlook**. Staff's projections envisage a deficit of 4.1 percent of GDP this year, with the broader cash balance falling to one month of total spending by the end of 2017. The deficit widens further to 5.7 percent of GDP in 2018 as infrastructure projects progress and then narrows to around 3 percent of GDP over the medium term.

**17. Public debt rises over the medium term.** The authorities tripled the annual borrowing limit to SI$900 million in the 2017 Budget, and raised the public debt-to-GDP ratio limit to 30 percent in a revised debt management strategy. The DSA indicates that the risk of debt distress is moderate, in line with the previous assessment, though it illustrates a high vulnerability to shocks. The nominal public debt-to-GDP ratio could exceed the 30 percent limit in 2028.

**18. Risks are, on balance, on the downside** (see Risk Assessment Matrix, Text-Table 3, Appendix IV). Mining sector potential (gold, nickel and bauxite) and lower-than-expected commodity prices could emerge as upsides, potentially adding to growth. Infrastructure investment (in energy, transport and internet connectivity) could boost growth more than currently expected. Tax reforms (Box 3) could boost revenues over the medium term and improve fiscal resilience. But on the downside fiscal pressures could increase in the run-up to the election; and natural disasters are an ever-present risk. External risks include volatile global financial conditions and weaker than expected growth in emerging market economies, including China. While the withdrawal of correspondent banking relationships has so far been limited, it is a non-negligible risk.

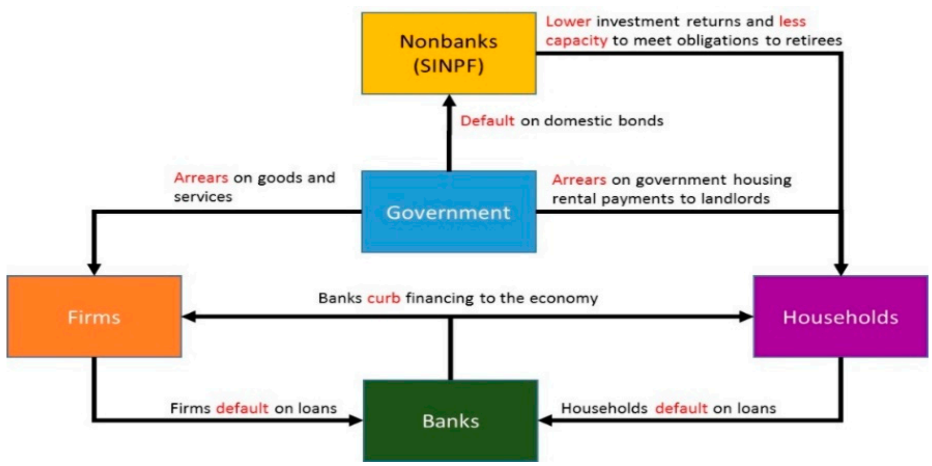
**Text Table 3. Solomon Islands: Summary Risk Assessment**

| | High Vulnerability, Risks to the Downside Dominate | Likelihood | Impact |
|---|---|---|---|
| **Upside** | 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. Lower oil prices | **Low** | **Medium** |
| **Downside** | 1. Fiscal policy slippage | **High** | **High** |
| | 2. Security risk | **Low** | **High** |
| | 3. Weaker-than-expected global growth, especially significant China slowdown. | **Medium** | **High** |
| | 4. Tighter or more volatile global financial conditions: | **High** | **Medium** |
| | 5. Reduced financial services by correspondent banks (globally) | **High** | **Medium** |
| | 6. Natural disasters and climate change | **High** | **High** |

**19. The deteriorating fiscal situation aggravates downside risks.** With a fast-shrinking fiscal cushion, Solomon Islands is ill-prepared to deal with any shock—external, natural disaster, social unrest, or combination of unexpected events. Fiscal strains could intensify these risks directly—by triggering unrest through non-payment of salaries and transfers—or indirectly as mounting arrears weigh on suppliers.

**20. Fiscal-financial linkages could amplify the risks.** Previous delays in the government's rental payments for civil servants' housing led to jumps in non-performing loans (NPLs) given banks' exposure to housing loans, and landlords' tendency to default on mortgage payments when rental payments are delayed. Although NPL spikes reversed quickly after landlords were paid, a protracted delay would dent banks' balance sheets. With the SI$150 million bond issue, the NPF holds 86.5 percent of the government's outstanding domestic debt securities. This is just 5 percent of the NPF's total assets, but it may start a trend raising financial sector exposure to the public sector.[3]

**Macrofinancial and Fiscal Linkages**




**Authorities' Views**

**21.** The authorities are more optimistic about growth prospects. The Gold Ridge mine could restart production soon and this, and other mining activities, would add to growth. Over the medium-term, the investment in the undersea cable would improve connectivity and infrastructure investment would yield returns, boosting growth and making a temporary increase in the debt burden manageable. 2016 was a peak year for logging and high volumes continued in 2017. While the logging industry would gradually decline over the medium term, the trajectory of the industry is highly uncertain.

# POLICY DISCUSSION

**22. Fiscal adjustment, tax reform and public financial management strengthening together with structural reforms and financial deepening would improve economic outcomes**. Better fiscal management would widen policymakers' options, increase the ability to respond to shocks and boost the efficiency of government spending. Financial deepening would help improve monetary policy effectiveness and expand financing options. Structural reforms, aimed at improving the business environment and ensuring strong compliance with regulations in key sectors, would promote sustainable development.

[3] Though domestic buffers are weakening, comfortable international reserves and the small scale of obligations should enable continued repayments to the Fund (Table 6).

## A. Restoring Fiscal Buffers

**Staff's Assessment**

**23. Remedial actions are needed to (i) stem domestic arrears and rebuild the cash balance; and (ii) place fiscal policy on a sustainably firmer footing**. Staff recommends a policy action scenario:

- **Rebuilding the cash balance.** Some welcome steps were taken for 2017 by revising down overly optimistic revenue projections, and asking line ministries to contain spending for the final months of the year. But more actions are needed to rebuild the cash balance to an adequate level. In the 2018 Budget staff recommend that the authorities aim for the broader cash balance of 1.3 months of spending gradually building to 2.0 months by 2020 (Table 6 sets out some possible measures).
- **A multi-year plan** is needed to get back on track, beginning with 2018 Budget. Staff sees a gradual cumulative consolidation of 6.0 percent of GDP by 2020 as feasible (see policy action scenario and measures, Tables 7, 8):
    - *Revenues*. The tax review is welcome (Box 3) but will take time to yield results.[4] For the near-term staff suggest aligning the tax reference price for logs to the world market prices from 2018 Q1 and eliminating ad-hoc tax exemptions. Efforts to improve compliance, and strengthen revenue administration should continue. Tackling tax arrears could significantly boost revenues—reducing outstanding cases by 5 percent by June 2018 and outstanding returns by 15 percent could generate up to 0.7 percent of GDP in additional revenues.
    - *Expenditures*. Recent efforts to curb spending were necessary but should be balanced by also restraining expenditures on tertiary scholarships, CDFs, and shipping grants. The 2018 Budget provides the opportunity to realign spending to the goals of the NDS and preserve critical social services. The use of department ceilings for annual expenditure is welcome. Discretionary recurrent expenditures—travel and allowances—can be scaled back. While the CDFs aim to provide public services to the rural population and fill gaps left by government, their use is opaque and there is little evidence available on their development impact. Reining in spending on CDFs and making them transparent is necessary to have an accurate picture of overall development spending. Spending allocations for 2018/19 should include room to eliminate domestic arrears.
    - **These measures should not adversely affect growth.** Fiscal multipliers are likely to be low, as the measures aim at improving the quality of spending. Moreover, tackling tax debt would improve equity, and addressing domestic arrears would instill confidence and reduce delays in capital spending (Table 7).[5]

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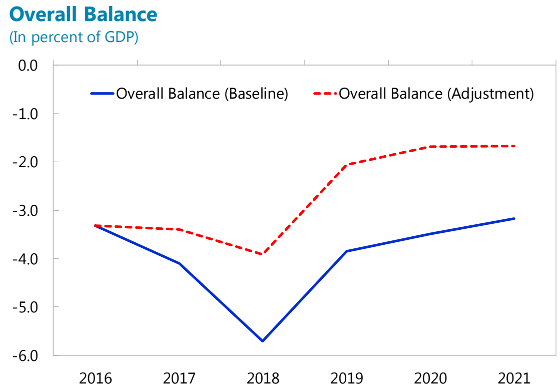
[4] Tax debts amount to 19.6 percent of GDP. 119 of the top 200 tax payers by turnover have arrears.

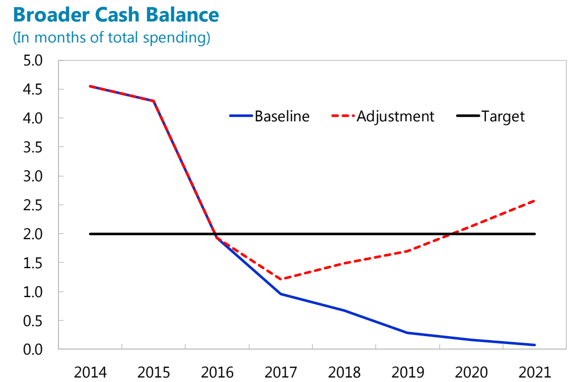
[5] Furthermore, the buckets approach (see A Simple Method to Compute Fiscal Multipliers) points to low fiscal multipliers for Solomon Islands: given high openness, weak PFM, and debt risks.

**Fiscal Deficit: Baseline and Alternative Scenario**




Sources: IMF staff estimates.

**Cash Balance**




Sources: IMF staff estimates.

- **Budget realism.** More realistic revenue projections would help establish the budget as a fiscal planning tool. Overly ambitious projections create cash management problems, and result in uncertainty for capital project execution.
- **Transparency of CDFs.** As a first step, the 2015 and 2016 annual reports of CDFs should be published. In the 2018 Budget, staff recommends publishing a supplement describing for each CDF: the planning process, use of funds, development achievements, and future-plans.[6]

## Box 3. Tax Review[1]

**The tax review sets the stage for an ambitious reform of tax policy and administration.** The review will span three years and involve broad stakeholder consultations. The current tax structure is described as a constraint on economic growth. Reform is seen as important given the prospective decline in revenues from logging exports, increased trade liberalization and to stem the erosion of tax base through tax exemptions.

**The first stage of the review focuses on tax administration and consumption taxes.** The second and third stages will focus on income tax, and other taxes, rents and excises. This sequence reflects the need to modernize tax administration arrangements as a prerequisite for successful tax reform and the relative importance of the consumption taxes (the goods tax, sales tax and import duty together account for 53.4 percent of tax revenue raised on domestic taxpayers). A major issue in the first-stage is whether to aim to make the current system work better or to introduce a value-added tax (VAT).

**The timeline for reforms needs to be considered carefully, particularly if the authorities opt to introduce VAT.** Experience of other economies in the region shows that VAT implementation takes time and can be accomplished within 18–24 months. The timeframe would need to consider the position of the Inland Revenue and the ease of information exchange with Customs. Consideration would also need to be given to data availability and calibration of the tax to ensure smooth rollout as compliance builds and administration patterns emerge over time.

[1] Prepared by Roman Didenko

[6] The CDF community audit report presented by Transparency Solomon Islands found that out of 1000 people interviewed in 39 constituencies, only 14 said they were aware and had basic knowledge of the CDF fund.

**Medium-Term Fiscal Policy Goals**

- **Better fiscal management is critical to address infrastructure and human development gaps.** Over the medium-term, there is space to increase external concessional borrowing and domestic borrowing. The borrowing strategy should be set in a medium-term fiscal framework, with clearly prioritized expenditures, and the pace of borrowing consistent with debt sustainability, absorptive capacity and domestic market development.
- **Choice of fiscal anchor**. Once the cash balance is restored, the cash balance and debt limit could be supplemented by an operational fiscal target to guide annual budgets and maintain discipline. A small deficit of 1.5 percent of GDP would contain debt levels and provide some space to close the infrastructure gap (see Box 4 and Selected Issue). Flexibility is also important—with specific provisions for adjustment in the event of a natural disaster.
- **Contingency reserve**. Including a specific contingency reserve line in the budget (of up to one month of nondiscretionary recurrent spending) would ease the delivery of assistance after a shock. Once fiscal buffers have been rebuilt, the authorities could go further and consider setting up a natural disaster fund.
- **Donor coordination and costing climate change adaptation**. The authorities only have a full view of development spending by the Solomon Islands Government (SIG) and not on aid programs conducted directly through line ministries by development partners. More complete collection and reporting of commitments and expenditures—through the budget, for non-appropriated donor assistance and via NGOs—would identify gaps, including in climate change and disaster risk mitigation. Reestablishing regular donor coordination meetings with government would improve information sharing.
- **Medium-Term Fiscal Strategy (MTFS).** Presentation of an MTFS analysis, including the expected fiscal costs from natural disasters and climate change adaptation, would help the assessment of tradeoffs between development spending and building buffers, including the benefits of investing in disaster risk reduction and contingency planning. As such, it could help mobilize external financing.
- **Public financial management strengthening should continue and critical vacancies should be filled.** The Accountant General position has been vacant since 2016. IMF technical assistance continues to support the authorities in implementing better cash-flow management and forecasting, monitoring and bank reconciliation, revenue forecasting, and handling tax debts. The public expenditure assessment roadmap provides a comprehensive set of reforms but to make progress it could be helpful to identify quick wins.

### Box 4. Fiscal Anchors: Options and Tradeoffs[1]

**A fiscal anchor could usefully supplement the fiscal framework to guide the annual budget cycle.** The Debt Management Strategy (DMS) stipulates a limit for the public debt-to-GDP ratio and debt service to domestically sourced revenue ratio set respectively at 30 percent and 10 percent. Under the Public Financial Management Act government borrowing cannot be used to finance recurrent expenditures.

**However, these targets are not binding and have not been sufficient to maintain fiscal discipline**. Public debt is substantially lower than the debt limit. The restriction on borrowing is ineffective as the main growth area is on development expenditures—but many of these, e.g. CDFs, include recurrent spending.

**A fiscal anchor would guide the annual budget discussion.** This could help contain fiscal deficits and prevent excessive public debt accumulation. It would create policy space for spending on infrastructure and human capital and provide a buffer to cushion against shocks.

**Simple numerical fiscal targets are divided into four types**. Countries choose one or a combination of fiscal rules of these based on their characteristics.

1) Budget balance rules (BBRs), set a specific target in overall balance, structural or cyclically adjusted balance, and balance "over the cycle", provide clear operational targets with direct links to debt sustainability, but may not address the procyclicality of fiscal policy. All balances except the overall balance take into account economic shocks which requires the estimation of adjustments through the output gap. These rules are difficult to communicate and monitor. The golden rule (GR), which targets the overall balance net of capital expenditures to safeguard public investment spending, is less linked to debt sustainability.
2) Debt rules (DRs) are directly linked to the debt target and are easy to communicate and monitor but do not provide sufficient guidance for fiscal policy, especially when debt is well below its ceiling.
3) Expenditure rules (ERs) are relatively easy to communicate and monitor but do not have a direct link to debt sustainability, as ERs do not cover revenues. However, ERs can provide an operational tool to trigger the required fiscal consolidation when ERs are accompanied by BBRs or DRs.
4) Revenue rules (RRs) can improve tax policy and administration but setting targets can be challenging as revenues are affected by the business cycle. RRs are not directly connected to debt sustainability, as RRs do not cover spending.

**Staff's analysis suggests that the 1.5 percent overall fiscal deficit target would ensure fiscal sustainability and meet high infrastructure demands.** A target for the overall balance has the advantage of being simple and comprehensive. It would help maintain a buffer to cope with shocks, and would need specific provision for adjustment in the face of a shock (including how policies would be brought back afterwards). Other options would be a non-commodity primary deficit target of 4 percent of GDP or a constraint on total spending.

[1] Prepared by Hidetaka Nishizawa.

**Authorities' Views**

**24. The fiscal setting has been challenging due to an acceleration of spending**. Moreover, investment is needed to reduce the large infrastructure gap and promote growth. Reaching staff's suggested policy action scenario would be difficult, although efforts are being made to raise revenues to cover expenditure needs. Further pressure on spending is anticipated ahead of the elections. Nonetheless, efforts will be made to rein in tertiary scholarship expenditures in 2018, including by improving candidate vetting. The CDFs play a critical role in rural areas to fill gaps in investment and services not provided by central government or donors. However, the importance of improving the transparency and accountability of CDFs is recognized. Where donor support is lacking, the authorities will continue to use domestic borrowing for larger infrastructure projects. Strengthened coordination with donors is an ongoing challenge and is being actively pursued.

**25. Staff's support for the tax review and compliance efforts is welcome.** The authorities are mindful of the pitfalls associated with tax reform. Once the government decides a way forward, they will explore the potential support of IMF technical assistance to help with design and implementation.

## B. Exchange Rate and Monetary Policy

**Staff's Assessment**

**26. The basket peg regime is working well and is appropriate for Solomon Islands.** With structural excess liquidity, CBSI balance sheet constraints, and weak interest rate transmission, the basket peg remains the most feasible nominal anchor for monetary policy. Staff assesses the external sector position to be moderately weaker than suggested by medium-term fundamentals and desirable policies—with a current account gap of 0-2 percentage points of GDP and REER overvaluation of 0-10 percent (Box 5). This is a legacy of the previous US dollar peg, followed by a tight operational band around the exchange rate against the US dollar which was removed in September 2014. Since 2014 the basket peg has operated well—with more variation against the US dollar and less against other currencies. Reviewing the parity of the peg annually and adjusting it when needed would help keep it in line with underlying developments. Improving the fiscal position would help sustain a balanced external position. Competitiveness would also improve with structural reform (paragraph 33).

**27. Monetary policy effectiveness and financial market development are best pursued together.** The accommodative policy stance is appropriate, given low inflation, an uncertain growth outlook, and moderate credit growth. Nonetheless a gradual increase in the CRR would be helpful to absorb structural excess liquidity.[7] The IMF has provided TA to help stem CBSI valuation losses which should strengthen the balance sheet and increase CBSI's ability to issue Bokolo bills.[8] Further market development is important for monetary policy implementation and debt management.

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[7] Structural excess liquidity reflects the accumulation of export receipts and unsterilized inflows of donor financing.

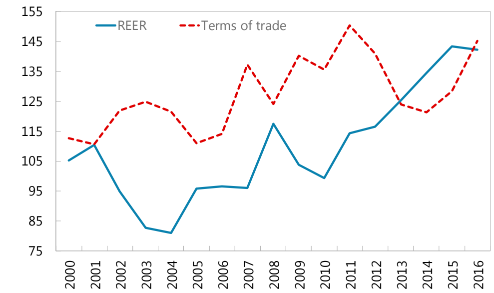
[8] The CBSI Act requires net assets to be at or above SI$50 million but they stood at -SI$13 million in March 2017.

## Box 5. External Sector Assessment[1]

**Staff's assessment suggests that the external sector position is moderately weaker than that consistent with medium term fundamentals and desirable policy settings.** This is based on REER developments, the CA EBA lite approach, the external sustainability approach, and the international reserves position.

**The REER has been on a rising trend since the end of the Tensions, apart from the period around the GFC.** Part of the recent rise is in line with an improvement in the terms of trade but a gap opened from 2012–14 pointing to an overvalued REER. Part of this gap was eroded with a recovery in export prices in 2016. and the changes in the operation of the basket peg (paragraph 6).

**Solomon Islands: REER and Terms of Trade**
(1986 = 100)




Sources: IMF staff calculations.

**The EBA Lite analysis also suggests the REER is moderately overvalued and the external sector position moderately weak**. To tailor estimates to Solomon Islands, two adjustments were made.

**Solomon Islands: EBA -Lite CA Analysis**

| | |
|---|---|
| **CA-Actual** | **-3.9%** |
| Cyclical Contributions (from model) | -1.2% |
| additional temporary/statistical factors | -1.3% |
| **Cyclically adjusted CA** | **-6.5%** |
| **CA-Norm** | **-6.3%** |
| Cyclical Contributions (from model) | -1.2% |
| additional adjustments to the norm | 3.0% |
| **Cyclically adjusted CA Norm** | **-4.5%** |
| CA-Gap | -2.0% |
| o/w Policy gap | 3.4% |
| Elasticity | -0.24 |
| REER Gap | 8.3% |

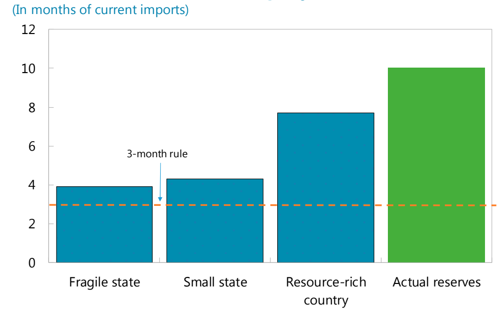
- The underlying current account balance was adjusted to remove a one-off boost to logging activity from the loosening of reserve-zone restrictions.
- The CA-norm was adjusted as aid flows are expected to be lower post-RAMSI. With these adjustments, staff estimates a cyclically adjusted actual current account balance of -6.5 percent of GDP, moderately weaker than the cyclically adjusted CA norm of -4.5 percent.
- The negative net international investment position should narrow somewhat in the medium-term to buffer against shocks (this occurs over a period when aid flows are declining). Based on external sustainability benchmarks, the real effective exchange rate is marginally on the strong side by 0–5 percent. Overall these approaches are consistent with an REER gap of 0–10 percent.

**External Sustainability Approach**

| | CA norm (% of GDP) | Underlying CA (% of GDP) | CA gap | REER gap |
|---|---|---|---|---|
| Scenario 1: Stabilizing net IIP at -10 percent of GDP in 2021 | -5.9 | -6.0 | -0.1 | 0.3 |
| Scenario 2: Stabilizing net IIP at -5 percent of GDP in 2021 | -4.8 | -6.0 | -1.2 | 5.0 |

**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 9.0 months import cover. However, staff expect reserve cover to fall back to around 7.5 months by 2022, just below the most stringent benchmark. Fragile conditions and vulnerability to natural disasters, are reflected by incorporating a higher probability of a large shock event (75 percent) compared to the sample average (50 percent).

**Solomon Islands: Reserve Adequacy Benchmarks**
(In months of current imports)




Sources: IMF staff calculations.

[1] Prepared by Fazurin Jamaludin, Irene Zhang and Stella Kaendera.

**Authorities' Views**

**28. The basket peg exchange rate regime is working well.** The external sector position is broadly in line with fundamentals—indeed the balance of private sector commentators view the exchange rate as being on the weak side.

**29. The accommodative monetary policy stance is appropriate, and excess reserves are not viewed as a concern, as credit growth has slowed and inflation is contained**. However, the CBSI emphasized that they continue to monitor the situation and would tackle excess reserves if credit growth or inflationary pressure accelerate markedly.

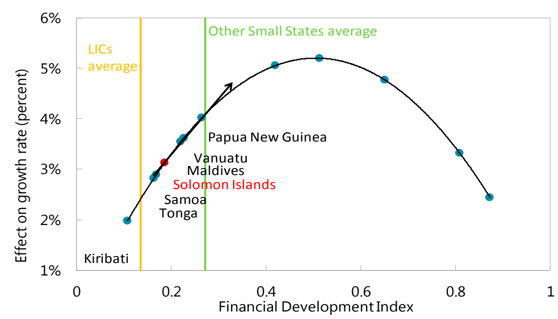
## C. Financial Sector and Structural Reforms to Support Inclusion and Growth

**Staff's Assessment**

**30. The financial sector is underdeveloped** (Figure 5). Solomon Islands has three foreign commercial banks (with the opening of BRED), one domestic bank, micro-credit unions, and the NPF which is a systemically-important financial institution (with assets equivalent to one third of GDP) and a large share of its assets held as bank deposits. Solomon Islands is among the most underbanked of the small states. The financial sector is inefficient with a small domestic market, a significant informal sector, difficulty securing collateral due to communal land ownership and high transaction costs. Interest rate spreads are among the highest in the Pacific (see WP/15/96).

**Financial development could support growth**

**Financial Development Effect on Growth**




Source: IMF staff estimates, based on the methodology in SDN/15/08 (Table A1), and Čihák and others (2012).

**31. Financial sector reforms, including those started under the ECF, should continue**.

- **Legislation.** A high priority should be given to clearing the backlog of financial legislation including the new Financial Institutions Act, Credit Unions Act, and National Provident Fund Act. These acts fill important gaps in prudential standards and would provide the basis for the CBSI to strengthen its supervisory framework.

- **Correspondent banking**. Though less of a problem than elsewhere, as remittances are relatively low, the risk posed by the withdrawal of correspondent banking nevertheless highlights the importance of ensuring the effectiveness and enforcement of the AML/CFT framework, including staffing and office space for the Financial Intelligence Unit.[9] All banks have access to correspondents, but one bank reported that finding *additional* links is challenging. Regional engagement, with development partners, banks, and supervisors is important.

[9] 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.

- **The NPF Act** offers the opportunity to strengthen the governance structure and international portfolio diversification (only 18 percent of its portfolio is invested abroad), which would lower excess liquidity. The proportion of retirement savings that can be used as collateral against loans should be reduced. An actuarial assessment of pension-system sustainability is overdue.

**32. The CBSI-led National Financial Inclusion Strategy 2016–20 provides a clear framework for financial development and inclusion.** Use of mobile banking is a viable solution to reach the widely-dispersed population and significant progress has been made (see Appendix V). Staff encouraged the authorities to continue its collaborative approach with commercial banks focused on improving financial literacy, introducing mobile payments, savings and other products, while ensuring that new services strike a balance between inclusion and financial stability.

**33. Structural reforms should foster private-sector development.** Narrowing the infrastructure gap requires better transport, communications, and energy services, as well as policies to promote competitiveness and sustainable development of key sectors. The enforcement of contracts, ease of trading across borders, insolvency resolution, access to finance, and property registration are areas for improvement. Solutions to challenges posed by communal land-ownership are pivotal for sectoral development and financial deepening but there are no easy fixes (in limited areas leasing has been a workable solution). The forestry sector faces depletion following overexploitation—strengthened compliance, reforestation and diversification into agroforestry/non-wood products can only help slow its decline. Strong regulatory enforcement will be particularly important in the mining and fisheries sectors.

**34. Combining public financial management reform with natural disaster mitigation would raise the benefits of public investment.** Investing in climate-proof infrastructure can minimize the adverse growth and fiscal volatility caused by natural disasters (Box 6 and Selected Issues paper), as well as lower long-term debt, as less resources are needed for reconstruction after natural disasters hit. PFM reform, by improving spending efficiency and reducing the rate of depreciation, can also help cut maintenance costs and boost gains from investing in climate-proof infrastructure.

**35. Measures to curb corruption would support the development agenda.** Recent IMF staff analyses show that, globally, corruption hinders sustainable and inclusive growth and weakens the ability of a government to perform its core functions. Staff would emphasize the role of fiscal transparency including finalizing financial instructions and procurement regulations under the PFM Act, transparency of CDFs, strengthening revenue compliance, improving the anti-corruption legal framework, and the contribution a stronger AML/CFT framework can make to anti-corruption efforts. The Government Integrity Group Forum could help improve inter-departmental coordination.

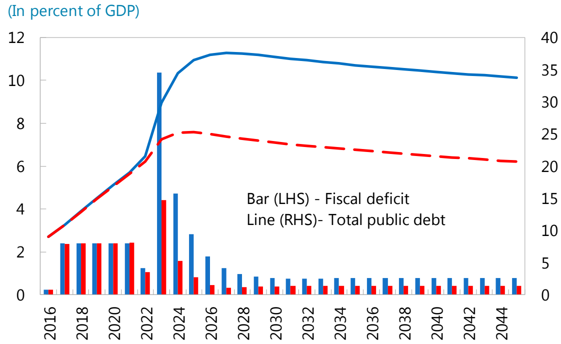
**36. The IMF staff is supporting the development agenda with technical assistance and training in core areas.** Appendix 1 illustrates the areas in which the IMF has a role in supporting NDS objectives. Recent technical assistance and training (see Informational Annex) have covered public financial management, public investment management, domestic revenue mobilization, reserves management and statistics. Support will continue in these areas and further support is likely on tax policy and revenue mobilization. A recent diagnostic assessment of the financial system identifies areas for further assistance. Training and policy advice stresses the importance of building resilience to natural disasters and incorporating potential costs in the budget.

## Box 6. Public Investment in the Face of Natural Disasters: A Model Application to Solomon Islands[1]

**Motivation.** The Solomon Islands Medium-Term Development Plan (MTDP) identifies the development and upgrade of infrastructure as a top priority. A tailored application of the Debt-Investment-Growth (DIG) model can illustrate the outcomes from different profiles of public investment and inform policy discussions.

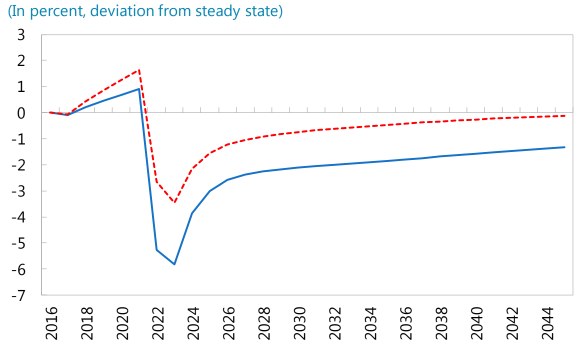
**Findings.** Staff applied the model developed by Marto, Papageorgiou, and Klyuev (2017), which extends the DIG framework by allowing the government to invest in both standard infrastructure and climate adaptation infrastructure. Three simulations look at Solomon Islands' vulnerability to natural disasters, low public investment efficiency, and limited access to financing. Staff found that conventional infrastructure has a more favorable effect on growth and private investment compared to disaster-resilient infrastructure in the short term. Despite the higher cost of adaptation infrastructure, it is more likely to be associated with lower public debt and higher growth in the long term, especially in a post-disaster context. Sustained public financial management reform can boost the gains from adaptation infrastructure, although the gains materialize gradually. Tapping concessional financing is the most optimal way to finance scaling up of capital spending.

**Fiscal Deficit and Total Public Debt**
(In percent of GDP)




Sources: IMF staff estimates.

**Real GDP Growth**
(In percent, deviation from steady state)




Sources: IMF staff estimates.

**Policy Implications.** Prioritizing public spending towards developing disaster-resilient infrastructure can yield long-term dividends. Timely reforms, including strengthening public investment management, can boost the gains from infrastructure investment. But given that PFM reforms require time to bear fruit, reforms should be pursued without delay. Tapping external concessional financing from development partners would be optimal since domestic borrowing can crowd out the private sector.

[1] Box and Selected Issue prepared by Fazurin Jamaludin, Ricardo Marto, and Irene Zhang.

### Authorities' Views

37. **The authorities noted the IMF staff's concern about legislative delays and welcomed support for the financial inclusion agenda.** There are many competing demands for legislative reform which has led to bottlenecks. The strategy on financial inclusion is wide-ranging and a key challenge for the second phase is to encourage greater usage of opened accounts. The authorities are keen to learn from global developments and innovations in financial inclusion. The

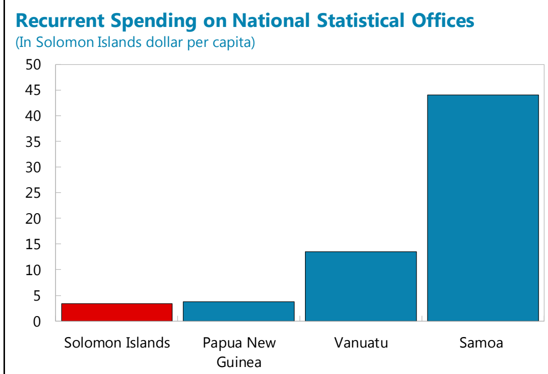
anti-corruption strategy remains on the agenda—it should support meeting the SDGs and would boost investor confidence. IMF technical assistance would be welcome, particularly following the tax review; and there is interest in assistance to support financial inclusion.

## D. Other Issues

**38. Efforts to improve data quality are welcome.** The National Statistics Development Strategy 2016–35 has a roadmap to address pressing gaps. Adequate resources and advisory capacity are necessary to sustain progress.

**39. The authorities agree on the need to continue to improve statistics**. The CBSI note the importance of a national CPI which the National Statistics Office is currently working on.

**National Statistical Office resources lag peers**




Sources: Solomon Islands National Statistical Office.

# STAFF APPRAISAL

**40. Economic activity has remained favorable but the outlook is uncertain**. Stronger-than-expected activity in the forestry sector, higher cash crops and fishing revenues, and stepped-up construction have supported growth. While the current account deficit widened moderately in 2016, international reserve levels remain comfortable and inflation is contained. On balance, risks to the outlook are on the downside. In particular, fiscal pressures, if not addressed, could weigh on growth, and natural disasters are an ever-present risk.

**41. Solomon Islands faces long-term development challenges and needs to generate new sources of growth.** The authorities' National Development Strategy (NDS), identifies priority sectors for development, specifies development objectives and aligns them to corresponding Sustainable Development Goals. Achieving the objectives of the NDS will entail additional efforts, including significant infrastructure investment, legislative and policy reforms.

**42. Decisive actions are needed to strengthen fiscal discipline and improve the quality of public spending**. Fiscal buffers have substantially eroded and payment arrears are on the rise. A shrinking fiscal cushion has reduced policy options and leaves the economy less well equipped to handle shocks. Timely actions are needed place the fiscal position on a firmer footing.

**43. Rebuilding the government cash balance and strengthening the medium term fiscal framework would help ensure fiscal sustainability.** The authorities are strongly encouraged to stem domestic arrears and begin rebuilding the cash balance by boosting revenues and containing spending. 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. The pace of borrowing for critical infrastructure should be kept aligned with debt sustainability, absorptive capacity and domestic market development.

44. **The authorities should sustain fiscal reform efforts.** Combining public financial management reforms with disaster risk mitigation would raise public investment returns and reduce fiscal and growth volatility. 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 strengthened revenue compliance, improvements to the legal framework, and a stronger AML/CFT framework, this would contribute to anti-corruption efforts. The recently launched tax review is a commendable step.

45. **The basket peg is working well and the monetary stance is broadly appropriate.** The external sector position is assessed by staff to be moderately weaker than suggested by medium-term fundamentals. The basket peg is an appropriate exchange rate regime for Solomon Islands but the parity of the peg should be reviewed annually, and if necessary adjusted to keep the exchange rate in line with changes in underlying conditions. The monetary stance is appropriate, although a gradual increase in the cash reserve requirement to absorb structural excess liquidity should be considered.

46. **High priority should be given to clearing the backlog of financial legislation**. This includes the new Financial Institutions Act, the Credit Unions Act, and National Provident Fund Act. These acts fill important gaps in prudential standards and would provide the basis for the CBSI to strengthen its supervisory framework. Efforts to promote financial inclusion are commendable and are working well.

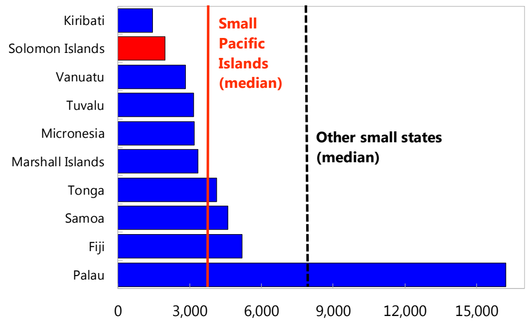
47. **Structural reforms should aim to foster private-sector development.** Improving the enforcement of contracts, access to finance, and property registration would help the business environment. Ensuring strong compliance with regulations is particularly important to promote sustainable development. Solutions to challenges posed by communal land-ownership will be important but there are no quick fixes.

48. **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 several challenges…*

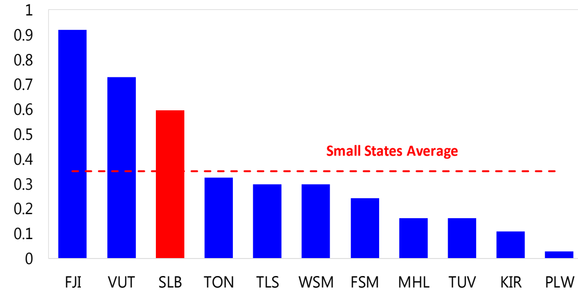
**GDP per Capita, 2016**
(In U.S. dollars)




Sources: Country authorities and IMF staff calculations

*…including vulnerability to natural disasters…*

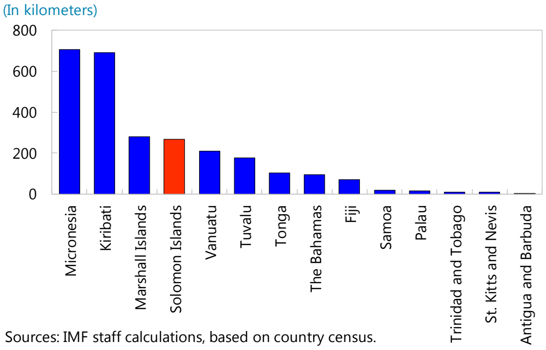
**Pacific Island Countries: Average Number of Natural Disasters per Year (1980-2016)**




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

*… geographical dispersion…*

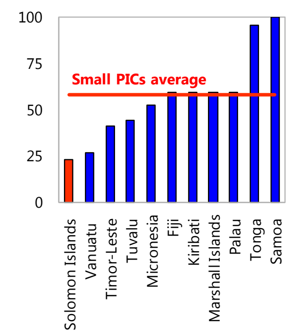
**Geographical Dispersion: Average Sea Distance Between Two Inhabitants of the Same Country**
(In kilometers)



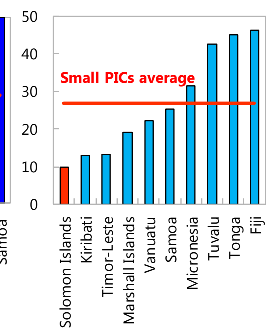

Sources: IMF staff calculations, based on country census.

*… high infrastructure gaps…*

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



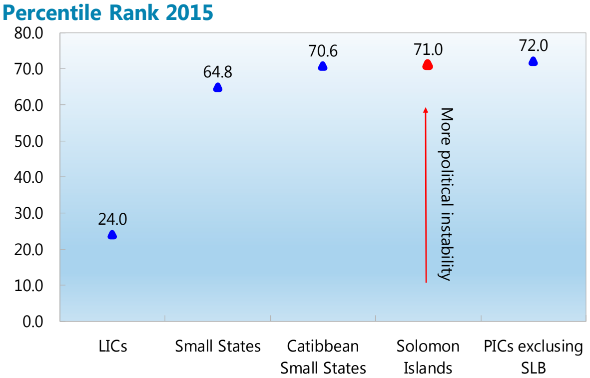

**Internet Users**
(Per 100 people)




Source: World Bank Group, WDI.

*..perception of lack of political stability…*

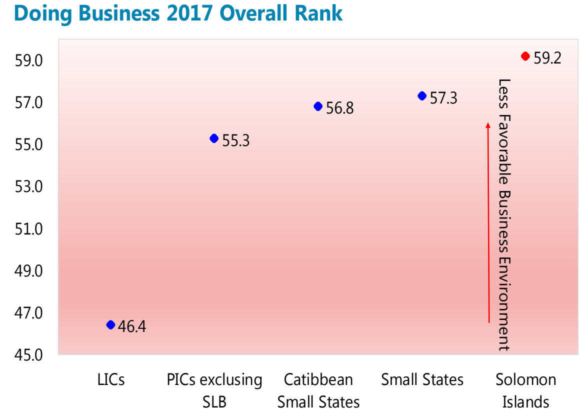
**Political Stability and Absence of Violence/Terrorism: Percentile Rank 2015**




Sources: World Governance Indicators

*..which affects the business environment.*

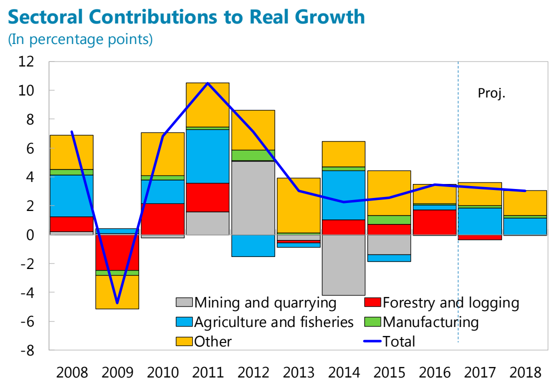
**Doing Business 2017 Overall Rank**



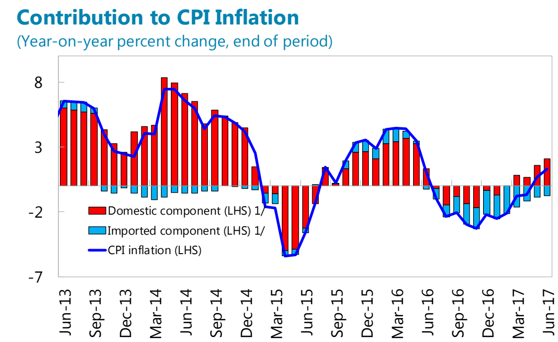

Sources: World Bank Doing Business Survey 2017

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

*Growth in 2016 was driven by stronger-than-expected logging activity and construction.*

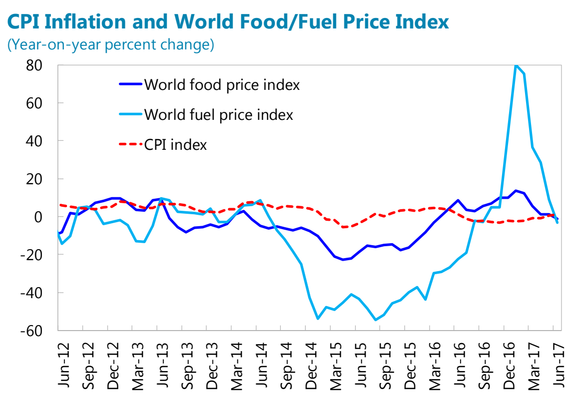



*Deflationary pressures have moderated...*

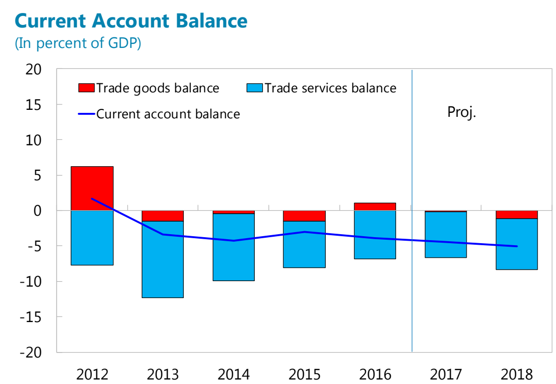



1/ Contribution to CPI inflation (in percentage points).
2/ A negative change means an appreciation of the Solomon Islands dollar against the Australian dollar.

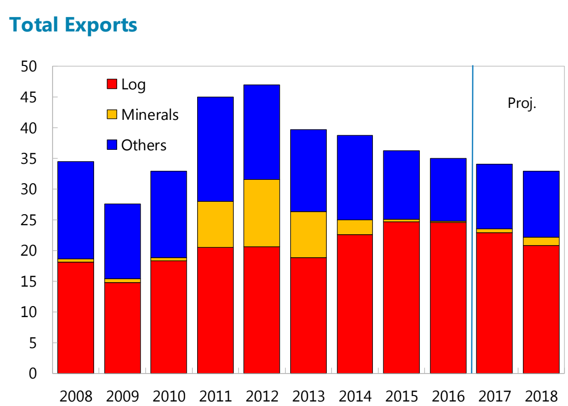
*...but prices remain contained amid broadly subdued global commodity prices.*



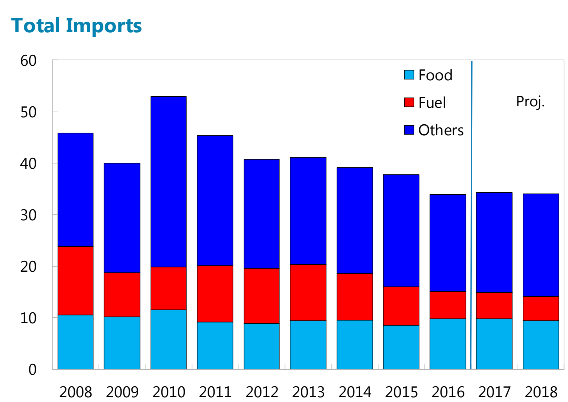

*The current account balance widened in 2016 given the larger-than-expected repatriation of dividends.*




*Logging continues to support exports...*




*...while imports have been contained by lower fuel prices.*

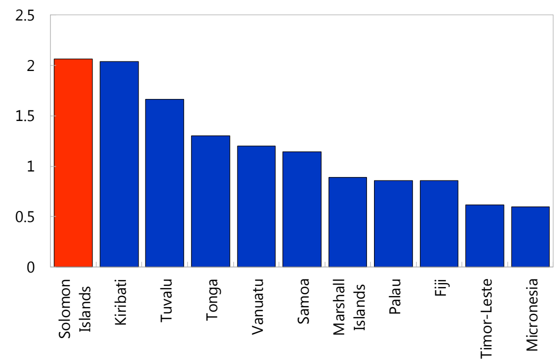



Sources: Country authorities and IMF Staff estimates.

## Figure 3. Solomon Islands: Fiscal Indicators

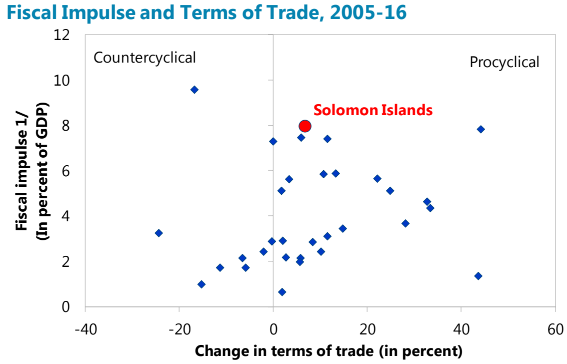
*Solomon Islands' high fiscal revenue volatility…*

### Volatility of Tax Revenue
(Standard deviation of detrended tax revenue-to-GDP ratio; 1990-2016)




*…leads to an often procyclical fiscal policy.*

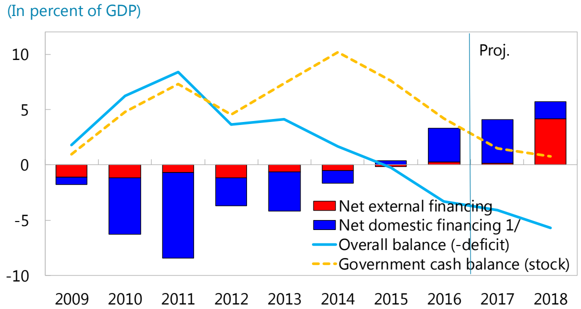
### Fiscal Impulse and Terms of Trade, 2005-16




1/ Fiscal impulse in year t is defined as the difference in cyclically adjusted overall balance in year t and t-1.

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

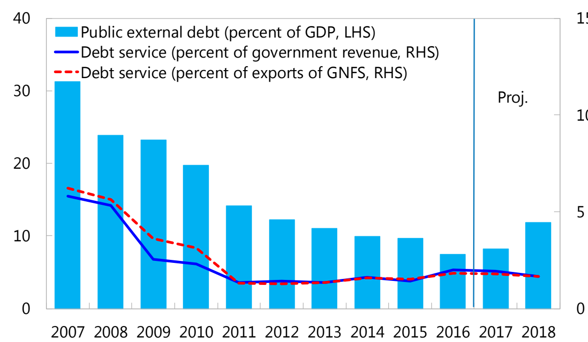
### Fiscal Balance and Financing
(In percent of GDP)




1/ Includes privatization receipts.

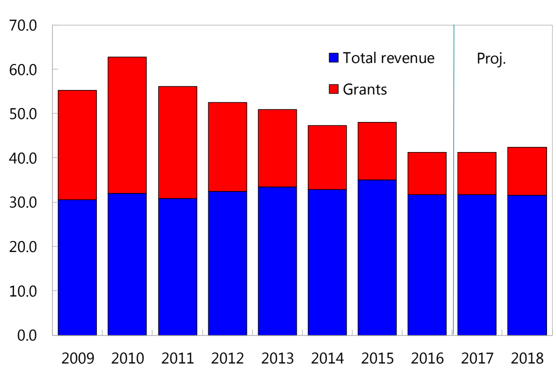
*….and as public debt increases to finance large infrastructure projects.*

### Public External Debt



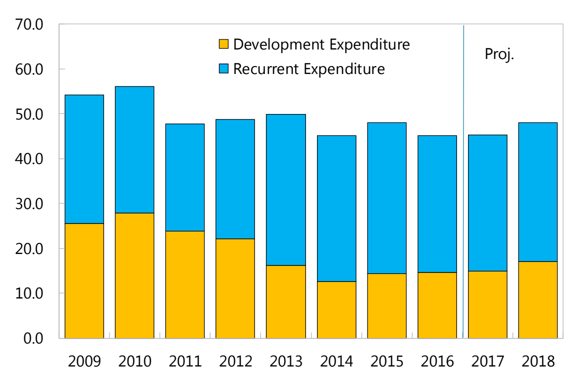

*Revenue collection is expected to be flat…*

### Government Revenue




*…amid elevated expenditure.*

### Government Expenditure

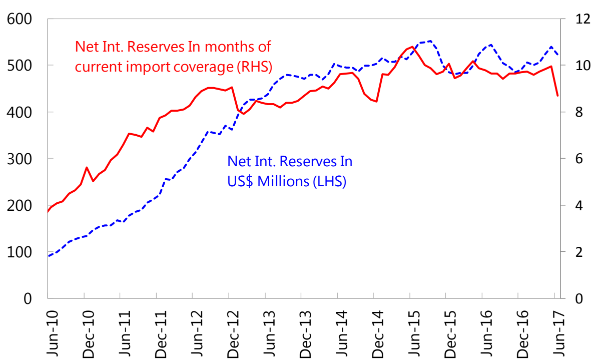



Sources: Country authorities and IMF staff estimates.

## Figure 4. Solomon Islands: Macroeconomic Developments and Outlook

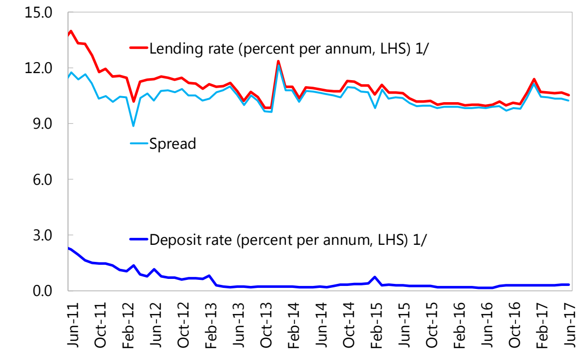
*Reserves remain adequate.*

### Net International Reserves




*While interest rates on loans remain high, they are below historical highs and are within PIC norms.*

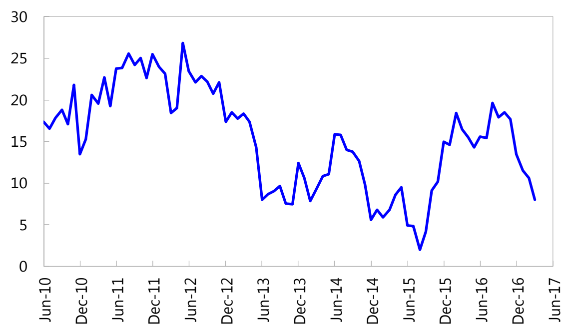
### Lending and Deposit Rates




*Money supply growth has slowed…*

### Broad Money

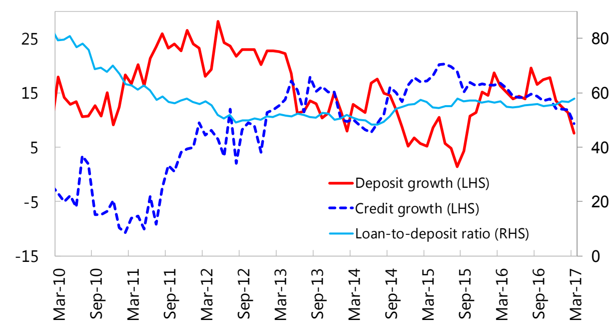
(Year-on-year percent change)



*…accompanied by slower credit growth.*

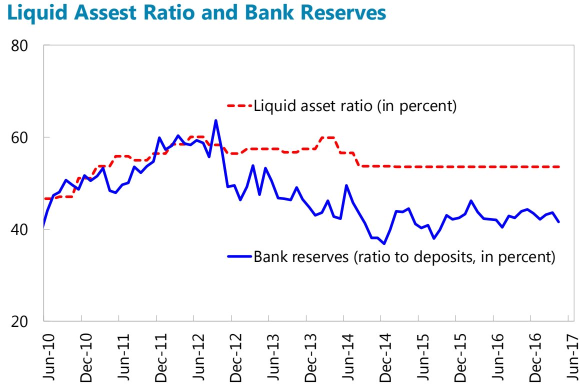
### Deposit and Credit Growth

(Year-on-year percent change)




*Banks' excess reserves remain high.*

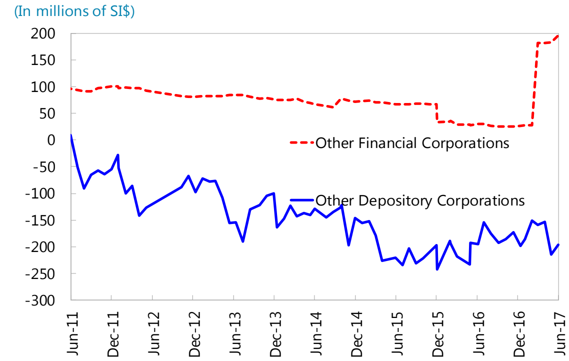
### Liquid Assest Ratio and Bank Reserves




*The recent Domestic Development Bond issuance has led to a spike in nonbanks' exposure to government credit.*

### Net Credit to Central Government

(In millions of SI$)



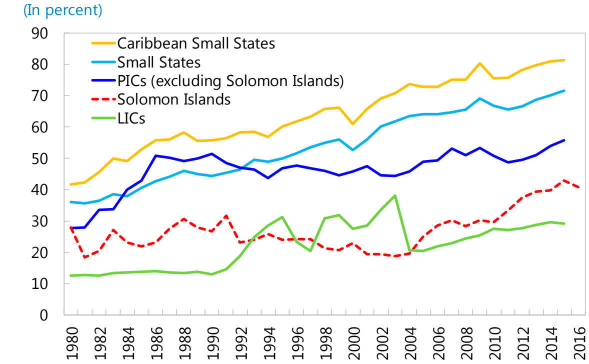

Sources: Central Bank of Solomon Isalnds and IMF staff estimates.

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

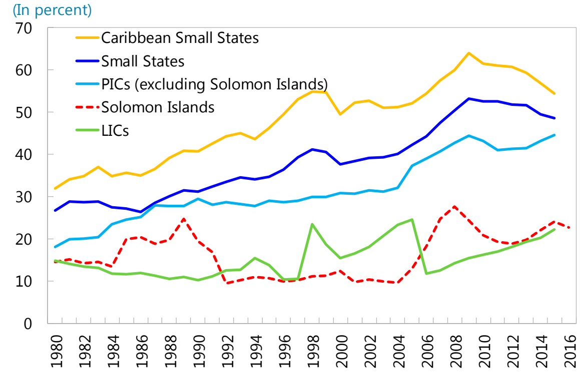
*The level of financial deepening, as measured by the relative size of deposits, has continuously increased…*

*…and credit to the private sector has been on an upward trend from a low base…*

### Domestic Bank Deposits to GDP
(In percent)



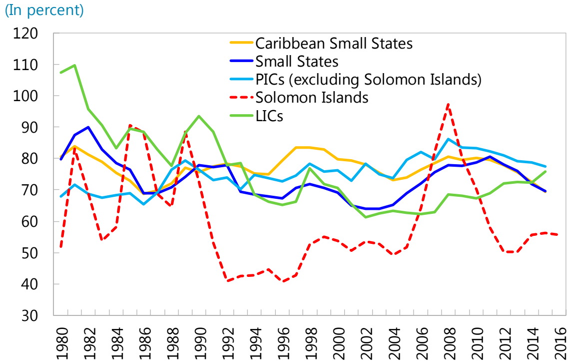

### Private Credit to GDP
(In percent)



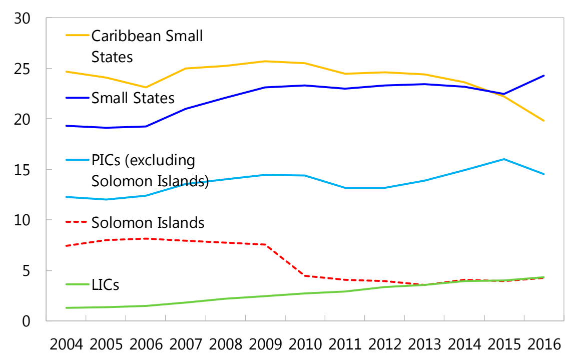

*…although Solomon Islands has generally lagged peers.*

*Geographical dispersion presents a major impediment for commercial banks' ability to reach customers…*

### Private Credit to Deposits
(In percent)



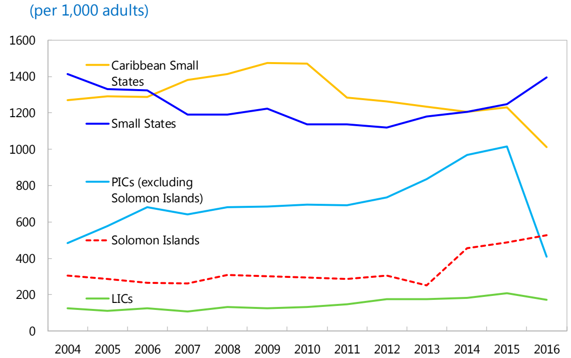

### Number of Branches, Commercial Banks
(Per 100,000 adults)



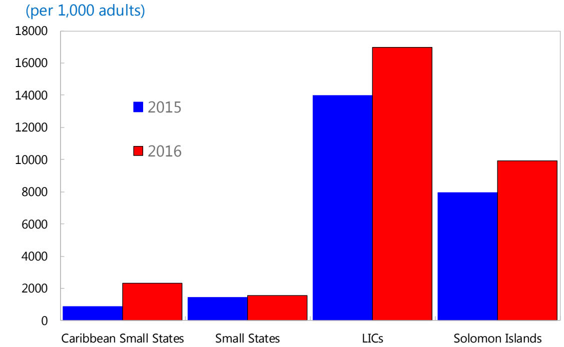

*… resulting in relatively low access to the banking system…*

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

### Accounts, Commercial Banks
(per 1,000 adults)




### Number of Mobile Money Trasanctions
(per 1,000 adults)




Sources: FinStats 2017 and Financial Access Survey.

## Table 1. Solomon Islands: Selected Economic Indicators 2013–22

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

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Est. | Proj. | Proj. | Proj. | Proj. | Proj. | Proj. |
| **GROWTH AND PRICES** | | | | Annual percentage change unless otherwise indicated | | | | | | |
| Real GDP | 3.0 | 2.3 | 2.5 | 3.5 | 3.2 | 3.0 | 2.9 | 2.8 | 2.8 | 2.8 |
| CPI (period average) | 5.4 | 5.2 | -0.6 | 0.5 | 1.0 | 1.2 | 2.0 | 2.7 | 3.0 | 4.0 |
| GDP deflator | 2.3 | 2.5 | 3.1 | 3.6 | 1.6 | 2.7 | 3.2 | 3.5 | 3.8 | 3.9 |
| Nominal GDP (in SI$ millions) | 8,250 | 8,646 | 9,139 | 9,798 | 10,281 | 10,884 | 11,564 | 12,297 | 13,117 | 14,012 |
| **CENTRAL GOVERNMENT OPERATIONS** | | | | | In percent of GDP | | | | | |
| Total revenue and grants | 50.9 | 47.3 | 47.9 | 41.2 | 41.2 | 42.4 | 42.0 | 41.6 | 41.3 | 41.1 |
| Revenue | 33.5 | 32.8 | 35.1 | 31.7 | 31.7 | 31.5 | 31.4 | 31.2 | 31.0 | 30.9 |
| Grants | 17.5 | 14.5 | 12.9 | 9.5 | 9.5 | 10.8 | 10.6 | 10.3 | 10.3 | 10.2 |
| Total expenditure | 46.8 | 45.6 | 48.2 | 44.5 | 45.3 | 48.1 | 45.8 | 45.1 | 44.5 | 44.2 |
| excluding grant-funded expenditure | 29.4 | 31.1 | 35.3 | 35.0 | 35.7 | 37.2 | 35.3 | 34.7 | 34.2 | 33.9 |
| Recurrent expenditure | 33.8 | 32.6 | 33.7 | 30.4 | 30.4 | 31.0 | 31.0 | 30.3 | 30.3 | 30.3 |
| Development expenditure | 16.2 | 12.6 | 14.3 | 14.7 | 14.9 | 17.1 | 14.9 | 14.7 | 14.2 | 13.9 |
| Unrecorded expenditure 1/ | -3.1 | 0.4 | 0.2 | -0.6 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Overall balance | 4.1 | 1.7 | -0.2 | -3.3 | -4.1 | -5.7 | -3.9 | -3.5 | -3.2 | -3.0 |
| Foreign financing (net) | -0.6 | -0.5 | -0.2 | 0.3 | 0.1 | 4.2 | 2.7 | 3.2 | 2.9 | 2.9 |
| Domestic financing (net) | -3.5 | -1.2 | 0.4 | 3.0 | 4.0 | 1.5 | 1.1 | 0.3 | 0.2 | 0.2 |
| Central government debt 1/ | 15.3 | 12.8 | 10.1 | 7.9 | 10.0 | 14.6 | 16.4 | 18.6 | 20.4 | 21.9 |
| Domestic debt | 4.2 | 2.9 | 0.5 | 0.4 | 1.8 | 2.7 | 2.5 | 2.4 | 2.2 | 2.1 |
| External debt | 11.1 | 9.9 | 9.7 | 7.5 | 8.2 | 11.9 | 13.9 | 16.2 | 18.2 | 19.9 |
| **MACROFINANCIAL** | | | | Annual percentage change (end of year) | | | | | | |
| Credit to private sector | 15.1 | 16.4 | 16.7 | 12.1 | 8.0 | 8.0 | 7.5 | 7.3 | 7.0 | 7.0 |
| Broad money | 12.4 | 5.6 | 15.0 | 13.4 | 10.1 | 11.9 | 5.3 | 4.5 | 4.6 | 4.0 |
| Reserve money | 3.0 | -10.1 | 23.5 | 14.5 | 9.0 | 6.7 | 5.3 | 4.5 | 4.4 | 4.0 |
| Deposit accounts with commercial banks per 1,000 adults | 251.8 | 454.3 | 487.5 | 526.2 | ... | ... | ... | ... | ... | ... |
| Loan accounts with commercial banks per 1,000 adults | 36.1 | 40.1 | 39.4 | 31.2 | | | | | | |
| **BALANCE OF PAYMENTS** | | | | In US$ millions unless otherwise indicated | | | | | | |
| Trade balance | -139.0 | -116.7 | -93.5 | -71.6 | -84.5 | -115.0 | -147.8 | -162.8 | -193.5 | -219.0 |
| (percent of GDP) | -12.3 | -9.9 | -8.1 | -5.8 | -6.6 | -8.3 | -10.1 | -10.5 | -11.7 | -12.4 |
| Current account balance | -38.5 | -50.1 | -35.2 | -48.7 | -56.1 | -69.5 | -93.9 | -105.1 | -98.6 | -110.1 |
| (percent of GDP) | -3.4 | -4.3 | -3.0 | -3.9 | -4.4 | -5.0 | -6.4 | -6.8 | -5.9 | -6.2 |
| Foreign direct investment | 50.4 | 20.3 | 27.6 | 36.0 | 58.6 | 34.8 | 52.9 | 58.0 | 63.3 | 63.6 |
| (percent of GDP) | 4.5 | 1.7 | 2.4 | 2.9 | 4.6 | 2.5 | 3.6 | 3.7 | 3.8 | 3.6 |
| Overall balance | 31.6 | -16.2 | 53.0 | 2.2 | -10.7 | 23.4 | -0.5 | 1.9 | 21.3 | 17.1 |
| Gross official reserves (in US$ millions, end of period) 2/ | 531.2 | 514.3 | 519.6 | 513.6 | 500.1 | 520.0 | 517.4 | 519.1 | 540.1 | 556.8 |
| (in months of next year's imports of GNFS) | 9.3 | 10.0 | 10.0 | 9.5 | 8.5 | 8.1 | 7.6 | 7.3 | 7.3 | 6.9 |
| Net official reserves (in US$ millions, end of period) | 511.5 | 496.2 | 505.6 | 503.5 | 492.8 | 516.2 | 515.7 | 517.6 | 538.9 | 556.0 |
| (in months of next year's imports of GNFS) | 9.0 | 9.6 | 9.7 | 9.3 | 8.4 | 8.1 | 7.6 | 7.3 | 7.2 | 6.9 |
| **EXCHANGE RATE** (SI$/US$, end of period) 3/ | 7.4 | 7.4 | 8.1 | 7.8 | ... | ... | ... | ... | ... | ... |
| Real effective exchange rate (end of period, 2005 = 100) 3/ | 135.1 | 144.7 | 154.3 | 153.2 | ... | ... | ... | ... | ... | ... |
| **MEMORANDUM ITEMS:** | | | | | | | | | | |
| Cash balance (in SI$ millions) | 608 | 880 | 694 | 412 | 154 | 87 | -44 | -83 | -113 | -139 |
| in months of recurrent spending | 3.7 | 5.1 | 3.6 | 2.0 | 0.7 | 0.4 | -0.1 | -0.3 | -0.3 | -0.4 |
| 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 | 140 | 140 | 140 |
| Broader cash balance (=Cash balance+ SIG Deposit Account; in SI$ millions) | 748 | 1,020 | 834 | 552 | 294 | 227 | 96 | 57 | 27 | 1 |
| in months of total spending 4/ | 3.7 | 4.6 | 3.1 | 1.9 | 1.0 | 0.7 | 0.3 | 0.2 | 0.1 | 0.0 |

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/ The 2016 numbers refer to June.
4/ 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 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Act. | Act. | Budget | Act. | Original Budget | Revised Estimates | Proj. | Budget Estimates | Proj. | Proj. | Proj. | Proj. | Proj. |
| | | | | | (In millions of Solomon Islands dollars) | | | | | | | | |
| Total revenue and grants | 4,089 | 4,381 | 3,953 | 4,037 | 4,535 | 4,237 | 4,234 | 4,666 | 4,610 | 4,854 | 5,113 | 5,417 | 5,764 |
| Total revenue | 2,835 | 3,206 | 3,024 | 3,108 | 3,555 | 3,257 | 3,254 | 3,489 | 3,433 | 3,634 | 3,841 | 4,067 | 4,330 |
| Tax revenue | 2,487 | 2,621 | 2,710 | 2,578 | 2,945 | 2,700 | 2,692 | 2,870 | 2,838 | 3,001 | 3,169 | 3,350 | 3,564 |
| Income and profits | 863 | 991 | 994 | 947 | 1,131 | 998 | 990 | 1,058 | 1,048 | 1,110 | 1,175 | 1,247 | 1,325 |
| Goods and services | 907 | 855 | 967 | 833 | 1,000 | 875 | 880 | 931 | 932 | 985 | 1,044 | 1,109 | 1,180 |
| International trade and transactions | 717 | 776 | 750 | 798 | 813 | 827 | 821 | 881 | 858 | 906 | 951 | 995 | 1,060 |
| Other revenue | 348 | 585 | 314 | 530 | 611 | 557 | 562 | 619 | 595 | 632 | 672 | 717 | 765 |
| Grants | 1,255 | 1,175 | 930 | 930 | 980 | 980 | 980 | 1,177 | 1,177 | 1,221 | 1,272 | 1,350 | 1,435 |
| Development grants | 521 | 434 | 389 | 389 | 412 | 412 | 412 | 576 | 576 | 582 | 596 | 632 | 672 |
| Recurrent budget grants | 734 | 742 | 541 | 541 | 568 | 568 | 568 | 601 | 601 | 639 | 676 | 717 | 762 |
| Expenditure | 3,945 | 4,402 | 4,472 | 4,363 | 4,658 | 4,998 | 4,655 | 5,378 | 5,231 | 5,300 | 5,542 | 5,832 | 6,190 |
| Of which: excluding grant-funded expenditure | 2,690 | 3,226 | 3,543 | 3,433 | 3,678 | 4,018 | 3,675 | 4,201 | 4,054 | 4,079 | 4,270 | 4,482 | 4,756 |
| Recurrent expenditure | 2,819 | 3,076 | 2,976 | 2,983 | 3,135 | 3,391 | 3,121 | 3,417 | 3,374 | 3,582 | 3,729 | 3,972 | 4,244 |
| Of which: excluding grant-funded expenditure | 2,085 | 2,335 | 2,435 | 2,442 | 2,567 | 2,823 | 2,553 | 2,816 | 2,773 | 2,943 | 3,053 | 3,254 | 3,482 |
| Compensation of employees | 847 | 1,005 | 1,000 | 1,009 | 1,029 | 1,027 | 1,027 | 1,102 | 1,081 | 1,143 | 1,209 | 1,283 | 1,371 |
| Interest payments | 11 | 40 | 9 | 9 | 15 | 15 | 15 | 22 | 22 | 31 | 33 | 36 | 39 |
| Other recurrent expenditure | 1,960 | 2,031 | 1,968 | 1,966 | 2,091 | 2,349 | 2,079 | 2,292 | 2,201 | 2,339 | 2,487 | 2,653 | 2,834 |
| Government funded | 1,226 | 1,290 | 1,426 | 1,425 | 1,523 | 1,781 | 1,511 | 1,691 | 1,600 | 1,700 | 1,811 | 1,935 | 2,071 |
| Grant-funded | 734 | 742 | 541 | 541 | 568 | 568 | 568 | 601 | 601 | 639 | 676 | 717 | 762 |
| Resolution of demestic arrears | | | | | | | | | 70 | 70 | | | |
| Development expenditure | 1089 | 1306 | 1,497 | 1,437 | 1,523 | 1,607 | 1,534 | 1,962 | 1,857 | 1,718 | 1,813 | 1,860 | 1,946 |
| Government funded development expenditure | 568 | 872 | 1,108 | 1,049 | 1,111 | 1,195 | 1,122 | 1,386 | 1,281 | 1,136 | 1,217 | 1,228 | 1,274 |
| Domestic | 568 | 872 | 1,108 | 944 | 1,111 | 1,113 | 1,040 | 867 | 762 | 765 | 785 | 800 | 833 |
| External loan | 0 | 0 | 0 | 104 | 0 | 82 | 82 | 519 | 519 | 371 | 432 | 428 | 441 |
| Grant funded | 521 | 434 | 389 | 389 | 412 | 412 | 412 | 576 | 576 | 582 | 596 | 632 | 672 |
| Discrepancy 1/ | 37 | 20 | 0 | -58 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Current balance 2/ | 750 | 871 | 589 | 665 | 988 | 434 | 701 | 673 | 660 | 690 | 788 | 813 | 848 |
| Primary balance | 156 | 20 | -510 | -212 | -107 | -746 | -406 | -690 | -599 | -415 | -396 | -380 | -387 |
| Overall balance | 144 | -20 | -519 | -325 | -123 | -761 | -421 | -712 | -621 | -446 | -429 | -415 | -426 |
| Total financing | -144 | 20 | 519 | 325 | 123 | 761 | 421 | 712 | 621 | 446 | 429 | 415 | 426 |
| Foreign (net) | -43 | -15 | -75 | 29 | -56 | 13 | 13 | 454 | 454 | 315 | 390 | 386 | 400 |
| Disbursements | 0 | 0 | 0 | 104 | 0 | 82 | 82 | 519 | 519 | 371 | 432 | 428 | 441 |
| Amortization | -43 | -16 | -75 | -75 | -56 | -70 | -70 | -64 | -64 | -56 | -42 | -42 | -42 |
| Domestic (net) | -102 | 36 | 594 | 296 | 179 | 749 | 408 | 258 | 167 | 131 | 39 | 30 | 26 |
| Of which : Change in cash balance (+=decrease) | -272 | 186 | 523 | 282 | 179 | 449 | 258 | | 67 | 131 | 39 | 30 | 26 |
| Change in public domestic debt (+=increase) | -32 | -131 | 0 | 0 | 0 | 300 | 147 | | 100 | 0 | 0 | 0 | 0 |
| Banking system | -98 | 74 | 594 | 304 | 179 | 449 | 258 | | 67 | 131 | 39 | 30 | 26 |
| Central bank | -115 | 170 | 594 | 260 | 179 | 449 | 258 | | 67 | 131 | 39 | 30 | 26 |
| Commercial banks | 17 | -96 | 0 | 44 | 0 | 0 | 0 | | 0 | 0 | 0 | 0 | 0 |
| Nonbank (National Provident Fund and SOEs) | -4 | -38 | 0 | -8 | 0 | 300 | 150 | | 100 | 0 | 0 | 0 | 0 |
| Memorandum items: | | | | | | | | | | | | | |
| Nominal GDP (in SI$ millions) | 8,646 | 9,139 | 9,798 | 9,798 | 10,281 | 10,281 | 10,281 | 10,884 | 10,884 | 11,564 | 12,297 | 13,117 | 14,012 |
| Public domestic debt (in SI$ millions) | 174 | 43 | 43 | 43 | 43 | 343 | 190 | | 290 | 290 | 290 | 290 | 290 |
| Narrow cash balance (in SI$ millions) 3/ | 880 | 694 | 171 | 412 | 234 | -37 | 154 | | 87 | -44 | -83 | -113 | -139 |
| in months of recurrent spending 4/ | 5.1 | 3.6 | 0.8 | 2.0 | 1.1 | -0.2 | 0.7 | | 0.4 | -0.2 | -0.3 | -0.4 | -0.5 |
| SIG Deposit Account (in SI$ millions) | 140 | 140 | 140 | 140 | 140 | 140 | 140 | | 140 | 140 | 140 | 140 | 140 |
| Broader cash balance (=Narrow cash balance+ SIG Deposit Account; in SI$ millions) | 1,020 | 834 | 311 | 552 | 374 | 103 | 294 | | 227 | 96 | 57 | 27 | 1 |
| in months of total spending 5/ | 4.6 | 3.1 | 1.1 | 1.9 | 1.2 | 0.3 | 1.0 | | 0.7 | 0.3 | 0.2 | 0.1 | 0.0 |
| Accumulated domestic arrears (in SI$ million) | | | | | | | 140 | | 70 | 0 | | | |
| Non-commodity primary balance 6/ (in SI$ millions) | -331 | -530 | -1,089 | -895 | -684 | -1,333 | -992 | -1,310 | -1,218 | -1,063 | -1,070 | -1,075 | -1,127 |

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

1/ Includes changes in the stock of unpaid payment orders and unpresented checks (+ = 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 unpresented 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/ 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 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Act. | Act. | Budget | Act. | Budget | | Proj. | Budget Estimates | Proj. | Proj. | Proj. | Proj. | Proj. |
| | (In percent of GDP) | | | | | | | | | | | | |
| Total revenue and grants | 47.3 | 47.9 | 40.3 | 41.2 | 44.1 | 41.2 | 41.2 | 42.9 | 42.4 | 42.0 | 41.6 | 41.3 | 41.1 |
| Total revenue | 32.8 | 35.1 | 30.9 | 31.7 | 34.6 | 31.7 | 31.7 | 32.1 | 31.5 | 31.4 | 31.2 | 31.0 | 30.9 |
| Tax revenue | 28.8 | 28.7 | 27.7 | 26.3 | 28.6 | 26.3 | 26.2 | 26.4 | 26.1 | 26.0 | 25.8 | 25.5 | 25.4 |
| Income and profits | 10.0 | 10.8 | 10.1 | 9.7 | 11.0 | 9.7 | 9.6 | 9.7 | 9.6 | 9.6 | 9.6 | 9.5 | 9.5 |
| Goods and services | 10.5 | 9.4 | 9.9 | 8.5 | 9.7 | 8.5 | 8.6 | 8.6 | 8.6 | 8.5 | 8.5 | 8.5 | 8.4 |
| International trade and transactions | 8.3 | 8.5 | 7.6 | 8.1 | 7.9 | 8.0 | 8.0 | 8.1 | 7.9 | 7.8 | 7.7 | 7.6 | 7.6 |
| Other revenue | 4.0 | 6.4 | 3.2 | 5.4 | 5.9 | 5.4 | 5.5 | 5.7 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 |
| Grants | 14.5 | 12.9 | 9.5 | 9.5 | 9.5 | 9.5 | 9.5 | 10.8 | 10.8 | 10.6 | 10.3 | 10.3 | 10.2 |
| Development grants | 6.0 | 4.7 | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 | 5.3 | 5.3 | 5.0 | 4.8 | 4.8 | 4.8 |
| Recurrent budget grants | 8.5 | 8.1 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 | 5.4 |
| Expenditure | 45.6 | 48.2 | 45.6 | 44.5 | 45.3 | 48.6 | 45.3 | 49.4 | 48.1 | 45.8 | 45.1 | 44.5 | 44.2 |
| Of which: excluding grant-funded expenditure | 31.1 | 35.3 | 36.2 | 35.0 | 35.8 | 39.1 | 35.7 | 38.6 | 37.2 | 35.3 | 34.7 | 34.2 | 33.9 |
| Recurrent expenditure | 32.6 | 33.7 | 30.4 | 30.4 | 30.5 | 33.0 | 30.4 | 31.4 | 31.0 | 31.0 | 30.3 | 30.3 | 30.3 |
| Of which: excluding grant-funded expenditure | 24.1 | 25.5 | 24.8 | 24.9 | 25.0 | 27.5 | 24.8 | 25.9 | 25.5 | 25.5 | 24.8 | 24.8 | 24.8 |
| Compensation of employees | 9.8 | 11.0 | 10.2 | 10.3 | 10.0 | 10.0 | 10.0 | 10.1 | 9.9 | 9.9 | 9.8 | 9.8 | 9.8 |
| Interest payments | 0.1 | 0.4 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 |
| Other recurrent expenditure | 22.7 | 22.2 | 20.1 | 20.1 | 20.3 | 22.8 | 20.2 | 21.1 | 20.2 | 20.2 | 20.2 | 20.2 | 20.2 |
| Government funded | 14.2 | 14.1 | 14.6 | 14.5 | 14.8 | 17.3 | 14.7 | 15.5 | 14.7 | 14.7 | 14.7 | 14.8 | 14.8 |
| Grant funded | 8.5 | 8.1 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 | 5.4 |
| Resolution of demestic arrears | | | | | | | | | 0.6 | 0.6 | | | |
| Development expenditure | 12.6 | 14.3 | 15.3 | 14.7 | 14.8 | 15.6 | 14.9 | 18.0 | 17.1 | 14.9 | 14.7 | 14.2 | 13.9 |
| Government funded | 6.6 | 9.5 | 11.3 | 10.7 | 10.8 | 11.6 | 10.9 | 12.7 | 11.8 | 9.8 | 9.9 | 9.4 | 9.1 |
| Domestic | 6.6 | 9.5 | 11.3 | 9.6 | 10.8 | 10.8 | 10.1 | 8.0 | 7.0 | 6.6 | 6.4 | 6.1 | 5.9 |
| External loan | 0.0 | 0.0 | 0.0 | 1.1 | 0.0 | 0.8 | 0.8 | 4.8 | 4.8 | 3.2 | 3.5 | 3.3 | 3.1 |
| Grant funded | 6.0 | 4.7 | 4.0 | 4.0 | 4.0 | 4.0 | 4.0 | 5.3 | 5.3 | 5.0 | 4.8 | 4.8 | 4.8 |
| Discrepancy 1/ | 0.4 | 0.2 | 0.0 | -0.6 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Current balance 2/ | 8.7 | 9.5 | 6.0 | 6.8 | 9.6 | 4.2 | 6.8 | 6.2 | 6.1 | 6.0 | 6.4 | 6.2 | 6.1 |
| Primary balance | 1.8 | 0.2 | -5.2 | -2.2 | -1.0 | -7.3 | -3.9 | -6.3 | -5.5 | -3.6 | -3.2 | -2.9 | -2.8 |
| Overall balance | 1.7 | -0.2 | -5.3 | -3.3 | -1.2 | -7.4 | -4.1 | -6.5 | -5.7 | -3.9 | -3.5 | -3.2 | -3.0 |
| Total financing | -1.7 | 0.2 | 5.3 | 3.3 | 1.2 | 7.4 | 4.1 | 6.5 | 5.7 | 3.9 | 3.5 | 3.2 | 3.0 |
| Foreign (net) | -0.5 | -0.2 | -0.8 | 0.3 | -0.5 | 0.1 | 0.1 | 4.2 | 4.2 | 2.7 | 3.2 | 2.9 | 2.9 |
| Disbursements | 0.0 | 0.0 | 0.0 | 1.1 | 0.0 | 0.8 | 0.8 | 4.8 | 4.8 | 3.2 | 3.5 | 3.3 | 3.1 |
| Amortization (accrual) | -0.5 | -0.2 | -0.8 | -0.8 | -0.5 | -0.7 | -0.7 | -0.6 | -0.6 | -0.5 | -0.3 | -0.3 | -0.3 |
| Domestic (net) | -1.2 | 0.4 | 6.1 | 3.0 | 1.7 | 7.3 | 4.0 | 2.4 | 1.5 | 1.1 | 0.3 | 0.2 | 0.2 |
| Of which : Change in cash balance (+=decrease) | -3.1 | 2.0 | 5.3 | 2.9 | 1.7 | 4.4 | 2.5 | | 0.6 | 1.1 | 0.3 | 0.2 | 0.2 |
| Change in public domestic debt (+=increase) | -0.4 | -1.4 | 0.0 | 0.0 | 0.0 | 2.9 | 1.4 | | 0.9 | 0.0 | 0.0 | 0.0 | 0.0 |
| Banking system | -1.1 | 0.8 | 6.1 | 3.1 | 1.7 | 4.4 | 2.5 | | 0.6 | 1.1 | 0.3 | 0.2 | 0.2 |
| Central bank | -1.3 | 1.9 | 6.1 | 2.7 | 1.7 | 4.4 | 2.5 | | 0.6 | 1.1 | 0.3 | 0.2 | 0.2 |
| Commercial banks | 0.2 | -1.1 | 0.0 | 0.5 | 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 | 0.0 | -0.1 | 0.0 | 2.9 | 1.5 | | 0.9 | 0.0 | 0.0 | 0.0 | 0.0 |
| Memorandum items: | | | | | | | | | | | | | |
| Accumulated domestic arrears (In percent of GDP) | | | | | | | 1.4 | | 0.6 | 0.0 | | | |
| Public domestic debt (In percent of GDP) | 2.0 | 0.5 | 0.4 | 0.4 | 0.4 | 3.3 | 1.8 | | 2.7 | 2.5 | 2.4 | 2.2 | 2.1 |
| Non-commodity primary balance (In percent of GDP) 3/ | -3.8 | -5.8 | -11.1 | -9.1 | -6.7 | -13.0 | -9.7 | -12.0 | -11.2 | -9.2 | -8.7 | -8.2 | -8.0 |

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

1/ Includes changes in the stock of unpaid payment orders and unpresented checks (+ = 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: Government Operations and Balance Sheet, 2014–16 1/

| | 2014<br>Act. | 2015<br>Act. | 2016<br>Act. |
|---|---|---|---|
| | (In millions of Solomon Islands dollars) | | |
| **Statement of operations** | | | |
| Revenue | 4,134 | 4,375 | 3,953 |
| Taxes | 2,521 | 2,664 | 2,614 |
| Income, profits, and capital gains | 834 | 955 | 913 |
| Property | 24 | 29 | 31 |
| Goods and services | 642 | 585 | 560 |
| International trade | 1,021 | 1,094 | 1,109 |
| Grants | 1,255 | 1,175 | 930 |
| Current | 734 | 742 | 541 |
| Capital | 521 | 434 | 389 |
| Other revenue | 358 | 535 | 409 |
| Expense | 2,971 | 3,175 | 3,261 |
| Compensation of employees | 949 | 1,060 | 1,147 |
| Use of goods and services | 1,575 | 1,513 | 1,553 |
| Interest | 13 | 12 | 11 |
| Subsidies | 0 | 20 | 1 |
| Grants | 183 | 161 | 178 |
| Social benefits | 40 | 108 | 38 |
| Other expense | 210 | 302 | 333 |
| Gross operating balance | 1,163 | 1,200 | 691 |
| Investment in nonfinancial assets | 954 | 1,116 | 1,081 |
| Expenditure | 3,924 | 4,292 | 4,343 |
| Net lending/net borrowing | 210 | 84 | -390 |
| Net acquisition of financial assets | 88 | -171 | -300 |
| Domestic | 123 | -163 | -354 |
| External | -35 | -8 | 54 |
| Net incurrence of liabilities | -78 | -175 | -57 |
| Domestic | -29 | -133 | 0 |
| External | -50 | -43 | -57 |
| Statistical dicrepancy 2/ | -43 | -79 | 147 |
| **Balance sheet** | | | |
| Net financial worth | 686 | 677 | 386 |
| Financial assets | 1,545 | 1,374 | 1,072 |
| Currency and deposits | 1,540 | 1,365 | 1,046 |
| Other accounts receivable | 5 | 10 | 26 |
| Liabilities | 859 | 697 | 686 |
| Debt securities | 173 | 43 | 43 |
| Loans | 685 | 655 | 643 |
| Other accounts payable | 1 | 0 | 1 |

1/ Budgetary central government.

2/ Net acquisition of financial assets minus net incurrenc of liabilities minus net lending/net borrowing.

## Table 4. Solomon Islands: Summary Accounts of the Banking System, 2014–22 1/

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Proj. | | | |
| | (In millions of Solomon Islands dollars, end of period) | | | | | | | | |
| Central Bank of Solomon Islands (CBSI) | | | | | | | | | |
| Net foreign assets (NFA) | 3,540 | 3,960 | 4,018 | 3,768 | 3,926 | 3,906 | 3,909 | 4,059 | 4,167 |
| Net international reserves (NIR) | 3,651 | 4,077 | 4,127 | 3,875 | 4,033 | 4,012 | 4,016 | 4,166 | 4,274 |
| Other NFA | -111 | -117 | -109 | -107 | -107 | -107 | -107 | -107 | -107 |
| Net domestic assets (NDA) | -1,708 | -1,698 | -1,429 | -1,018 | -1,182 | -1,208 | -1,299 | -1,546 | -1,770 |
| Net claims on central government | -1,280 | -1,110 | -850 | -663 | -791 | -867 | -1,049 | -1,246 | -1,450 |
| Claims | 69 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 |
| Deposits | 1,349 | 1,115 | 855 | 668 | 796 | 873 | 1,054 | 1,251 | 1,455 |
| Other items (net) | 136 | 149 | 134 | 140 | 155 | 155 | 155 | 155 | 155 |
| Reserve money | 1,832 | 2,262 | 2,589 | 2,750 | 2,744 | 2,698 | 2,610 | 2,512 | 2,397 |
| Currency in circulation | 658 | 740 | 828 | 869 | 977 | 1,038 | 1,107 | 1,183 | 1,266 |
| Bank deposits | 1,165 | 1,511 | 1,748 | 1,868 | 1,752 | 1,644 | 1,485 | 1,311 | 1,111 |
| Other deposits | 9 | 11 | 13 | 13 | 15 | 16 | 17 | 18 | 20 |
| Other depository corporations | | | | | | | | | |
| NFA of commercial banks | 287 | 169 | 155 | 134 | 159 | 180 | 185 | 190 | 195 |
| Assets | 365 | 281 | 305 | 283 | 308 | 329 | 334 | 339 | 344 |
| Liabilities | 77 | 112 | 150 | 149 | 149 | 149 | 149 | 149 | 149 |
| NDA of commercial banks | 1,516 | 1,750 | 1,999 | 2,204 | 2,421 | 2,356 | 2,268 | 2,181 | 2,067 |
| Net claims on central government | -146 | -243 | -198 | -4 | 96 | 96 | 96 | 96 | 96 |
| Claims | 44 | 15 | 19 | 169 | 269 | 269 | 269 | 269 | 269 |
| Deposits | 190 | 257 | 217 | 173 | 173 | 173 | 173 | 173 | 173 |
| Claims on the private sector | 1,697 | 1,981 | 2,221 | 2,399 | 2,591 | 2,785 | 2,988 | 3,197 | 3,421 |
| Other items (net) | -35 | 12 | -24 | -191 | -266 | -525 | -816 | -1,112 | -1,450 |
| Reserves and vault cash | 1,248 | 1,596 | 1,834 | 1,971 | 1,868 | 1,767 | 1,617 | 1,451 | 1,261 |
| Deposits | 3,051 | 3,515 | 3,988 | 4,309 | 4,447 | 4,303 | 4,070 | 3,823 | 3,523 |
| Depository corporations survey | | | | | | | | | |
| NFA of the banking system | 3,827 | 4,129 | 4,173 | 3,902 | 4,084 | 4,086 | 4,094 | 4,249 | 4,362 |
| Central bank | 3,540 | 3,960 | 4,018 | 3,768 | 3,926 | 3,906 | 3,909 | 4,059 | 4,167 |
| Other depository corporations | 287 | 169 | 155 | 134 | 159 | 180 | 185 | 190 | 195 |
| NDA of the banking system | -192 | 52 | 570 | 1,186 | 1,239 | 1,148 | 968 | 635 | 297 |
| Net claims on central government | -1,426 | -1,352 | -1,048 | -667 | -695 | -771 | -953 | -1,150 | -1,354 |
| Claims on the private sector 2/ | 1,703 | 1,988 | 2,229 | 2,406 | 2,598 | 2,793 | 2,996 | 3,205 | 3,429 |
| Other items (net) | -469 | -584 | -611 | -554 | -664 | -873 | -1,074 | -1,420 | -1,778 |
| Broad money (M3) | 3,635 | 4,181 | 4,743 | 5,088 | 5,324 | 5,234 | 5,063 | 4,884 | 4,659 |
| M1 | 2,653 | 3,272 | 3,521 | 3,750 | 3,924 | 3,858 | 3,731 | 3,600 | 3,434 |
| Currency outside banks | 575 | 655 | 742 | 766 | 861 | 915 | 976 | 1,043 | 1,116 |
| Demand deposits | 2,078 | 2,617 | 2,779 | 2,984 | 3,063 | 2,943 | 2,756 | 2,557 | 2,318 |
| Savings and time deposits | 982 | 908 | 1,221 | 1,338 | 1,400 | 1,376 | 1,331 | 1,284 | 1,225 |
| | (Annual percentage change, unless otherwise indicated) | | | | | | | | |
| Reserve money | -10.1 | 23.5 | 14.5 | 6.2 | -0.2 | -1.7 | -3.3 | -3.7 | -4.6 |
| Credit to the private sector | 16.4 | 16.7 | 12.1 | 8.0 | 8.0 | 7.5 | 7.3 | 7.0 | 7.0 |
| Broad money | 5.6 | 15.0 | 13.4 | 7.3 | 4.6 | -1.7 | -3.3 | -3.5 | -4.6 |
| Memorandum items: | | | | | | | | | |
| Money multiplier (level) | 2.0 | 1.8 | 1.8 | 1.9 | 1.9 | 1.9 | 1.9 | 1.9 | 1.9 |
| Loan-to-deposit ratio (in percent) | 55.6 | 56.4 | 55.7 | 55.7 | 58.3 | 64.7 | 73.4 | 83.6 | 97.1 |
| 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 | -642 | -670 | -746 | -928 | -1,125 | -1,329 |
| 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: Balance of Payments, 2013–22 1/

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Proj. | | | |
| | | | | (In millions of U.S. dollars) | | | | | | |
| Current account balance | -38.5 | -50.1 | -35.2 | -48.7 | -56.1 | -69.5 | -93.9 | -105.1 | -98.6 | -110.1 |
| Trade balance for goods | -16.8 | -4.9 | -17.2 | 12.8 | -2.3 | -16.3 | -43.5 | -56.0 | -75.0 | -93.8 |
| Exports | 447.8 | 455.2 | 420.3 | 432.1 | 434.8 | 452.7 | 476.5 | 498.3 | 502.2 | 509.1 |
| Imports | -464.6 | -460.1 | -437.5 | -419.4 | -437.1 | -469.0 | -520.0 | -554.3 | -577.3 | -602.9 |
| Trade balance for services | -122.2 | -111.8 | -76.3 | -84.4 | -82.2 | -98.7 | -104.3 | -106.8 | -118.4 | -125.2 |
| Exports | 125.7 | 111.8 | 106.4 | 122.7 | 129.7 | 136.8 | 143.7 | 150.8 | 158.2 | 165.7 |
| Imports | -247.9 | -223.6 | -182.7 | -207.2 | -211.9 | -235.5 | -247.9 | -257.6 | -276.6 | -290.9 |
| Income balance | -18.1 | -35.7 | -24.2 | -41.6 | -46.8 | -47.3 | -48.4 | -54.6 | -33.7 | -32.9 |
| Current transfers balance | 118.6 | 102.3 | 82.4 | 64.5 | 75.2 | 92.7 | 102.2 | 112.3 | 128.5 | 141.8 |
| *Of which*: Official transfers, net | 103.7 | 86.6 | 78.2 | 80.8 | 89.4 | 105.6 | 110.9 | 116.6 | 128.3 | 136.9 |
| Capital and financial account balance | 96.2 | 62.3 | 88.6 | 93.4 | 65.5 | 112.8 | 113.4 | 127.0 | 139.9 | 147.2 |
| Capital account balance | 86.7 | 70.6 | 55.2 | 53.3 | 25.6 | 36.4 | 36.8 | 37.7 | 36.0 | 38.3 |
| Direct investment balance | 50.4 | 20.3 | 27.6 | 36.0 | 58.6 | 34.8 | 52.9 | 58.0 | 63.3 | 63.6 |
| Portfolio investment balance | 0.1 | 0.4 | -0.7 | -1.7 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other investment balance | -41.0 | -29.0 | 6.5 | 5.8 | -18.8 | 41.6 | 23.7 | 31.3 | 40.7 | 45.4 |
| Assets | -16.0 | -17.1 | 16.2 | -7.5 | -9.2 | -10.3 | -9.5 | -7.6 | -7.7 | -7.6 |
| of which, amortization of official loans | -6.4 | -7.7 | -6.8 | -9.2 | -8.8 | -8.2 | -7.1 | -5.4 | -5.3 | -5.2 |
| Liabilities | -25.0 | -12.0 | -9.7 | 13.3 | -9.5 | 51.8 | 33.2 | 38.9 | 48.3 | 53.0 |
| of which, disbursement of official loans (incl. SDR) | 0.2 | 0.4 | 0.2 | 13.1 | 10.2 | 65.6 | 46.9 | 54.6 | 54.1 | 55.8 |
| Errors and omissions | -26.0 | -28.5 | -0.3 | -42.5 | -20.0 | -20.0 | -20.0 | -20.0 | -20.0 | -20.0 |
| Overall balance | 31.6 | -16.2 | 53.0 | 2.2 | -10.7 | 23.4 | -0.5 | 1.9 | 21.3 | 17.1 |
| Financing | -31.4 | 15.1 | -54.3 | -5.2 | 10.7 | -23.4 | 0.5 | -1.9 | -21.3 | -17.1 |
| Change in gross reserves (- = increase) | -31.6 | 16.2 | -53.0 | -2.2 | 13.6 | -19.9 | 2.6 | -1.7 | -21.0 | -16.8 |
| IMF | 0.2 | -1.1 | -1.2 | -3.1 | -2.9 | -3.4 | -2.1 | -0.2 | -0.3 | -0.3 |
| | | | | (In percent of GDP, unless otherwise indicated) | | | | | | |
| Current account | -3.4 | -4.3 | -3.0 | -3.9 | -4.4 | -5.0 | -6.4 | -6.8 | -5.9 | -6.2 |
| Trade balance for goods | -1.5 | -0.4 | -1.5 | 1.0 | -0.2 | -1.2 | -3.0 | -3.6 | -4.5 | -5.3 |
| Exports | 39.6 | 38.8 | 36.3 | 35.0 | 34.1 | 32.9 | 32.6 | 32.0 | 30.3 | 28.7 |
| Imports | 41.1 | 39.2 | 37.8 | 34.0 | 34.2 | 34.1 | 35.5 | 35.6 | 34.8 | 34.0 |
| *Of which:* Official transfers net | 9.2 | 7.4 | 6.8 | 6.5 | 7.0 | 7.7 | 7.6 | 7.5 | 7.7 | 7.7 |
| Capital account balance | 7.7 | 6.0 | 4.8 | 4.3 | 2.0 | 2.6 | 2.5 | 2.4 | 2.2 | 2.2 |
| Direct investment balance | 4.5 | 1.7 | 2.4 | 2.9 | 4.6 | 2.5 | 3.6 | 3.7 | 3.8 | 3.6 |
| *Of which:* Inward FDI 2/ | 4.7 | 1.8 | 2.8 | 3.0 | 4.5 | 2.5 | 3.6 | 3.7 | 3.8 | 3.6 |
| Other investment balance | -3.6 | -2.5 | 0.6 | 0.5 | -1.5 | 3.0 | 1.6 | 2.0 | 2.5 | 2.6 |
| Memorandum items | | | | | | | | | | |
| Net international reserves (in US$ million) | 512 | 496 | 506 | 503 | 493 | 516 | 516 | 518 | 539 | 556 |
| In months of next year's GNFS | 9.0 | 9.6 | 9.7 | 9.3 | 8.4 | 8.1 | 7.6 | 7.3 | 7.2 | 6.9 |
| Gross official foreign reserves (in US$ million) 3/ | 531 | 514 | 520 | 514 | 500 | 520 | 517 | 519 | 540 | 557 |
| In months of next year's imports of GNFS | 9.3 | 10.0 | 10.0 | 9.5 | 8.5 | 8.1 | 7.6 | 7.3 | 7.3 | 6.9 |
| Gross external public debt | 11.1 | 9.9 | 9.7 | 7.5 | 8.2 | 11.9 | 13.9 | 16.2 | 18.2 | 19.9 |
| Disbursement of concessional borrowing (in US$ millions) | 0.2 | 0.4 | 0.2 | 13.1 | 10.2 | 65.6 | 46.9 | 54.6 | 54.1 | 55.8 |
| External public debt service (in percent of exports of GNFS) | 1.4 | 1.6 | 1.5 | 1.8 | 1.8 | 1.6 | 1.4 | 1.1 | 1.2 | 1.2 |

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 BPM6

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

## Table 6. Solomon Islands: Indicators of Capacity to Repay the Fund, 2017–26

| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | Proj. | | | | | |
| Fund obligations based on existing credit (in SDR millions) | | | | | | | | | | |
| Principal | 2.77 | 2.46 | 1.46 | 0.13 | 0.19 | 0.21 | 0.16 | 0.13 | 0.07 | 0.03 |
| Charges and interest | 0.02 | 0.05 | 0.05 | 0.05 | 0.05 | 0.05 | 0.05 | 0.05 | 0.05 | 0.05 |
| In millions of SDRs | 2.79 | 2.51 | 1.51 | 0.18 | 0.24 | 0.26 | 0.21 | 0.18 | 0.12 | 0.08 |
| In millions of US$ | 3.93 | 3.53 | 2.13 | 0.25 | 0.34 | 0.37 | 0.30 | 0.25 | 0.17 | 0.11 |
| In percent of gross international reserves | 0.76 | 0.65 | 0.38 | 0.04 | 0.05 | 0.06 | 0.04 | 0.04 | 0.02 | 0.02 |
| In percent of exports of goods and services | 0.70 | 0.60 | 0.34 | 0.04 | 0.05 | 0.05 | 0.04 | 0.03 | 0.02 | 0.01 |
| In percent of debt service | 40.5 | 39.8 | 29.1 | 3.4 | 4.4 | 4.5 | 3.4 | 2.7 | 1.6 | 1.0 |
| In percent of GDP | 0.31 | 0.26 | 0.15 | 0.02 | 0.02 | 0.02 | 0.02 | 0.01 | 0.01 | 0.00 |
| In percent of quota | 13.4 | 12.1 | 7.3 | 0.9 | 1.2 | 1.3 | 1.0 | 0.9 | 0.6 | 0.4 |
| Outstanding Fund credit | | | | | | | | | | |
| In millions of SDRs | 4.85 | 2.40 | 0.94 | 0.80 | 0.61 | 0.40 | 0.24 | 0.10 | 0.03 | 0.00 |
| In millions of US$ | 6.83 | 3.38 | 1.32 | 1.13 | 0.86 | 0.56 | 0.34 | 0.14 | 0.04 | 0.00 |
| In percent of gross international reserves | 1.31 | 0.62 | 0.24 | 0.19 | 0.14 | 0.09 | 0.05 | 0.02 | 0.01 | 0.00 |
| In percent of exports of goods and services | 1.21 | 0.57 | 0.21 | 0.17 | 0.13 | 0.08 | 0.05 | 0.02 | 0.00 | 0.00 |
| In percent of debt service | 50.0 | 27.0 | 12.8 | 10.7 | 7.9 | 4.9 | 2.8 | 1.0 | 0.3 | 0.0 |
| In percent of GDP | 0.54 | 0.25 | 0.09 | 0.07 | 0.05 | 0.03 | 0.02 | 0.01 | 0.00 | 0.00 |
| In percent of quota | 23.3 | 11.5 | 4.5 | 3.8 | 2.9 | 1.9 | 1.2 | 0.5 | 0.1 | 0.0 |
| Memorandum items: | | | | | | | | | | |
| Exports of goods and services (in US$ millions) | 564 | 589 | 620 | 649 | 660 | 674 | 732 | 860 | 866 | 905 |
| Gross international reserves (in US$ millions) | 520 | 542 | 561 | 594 | 615 | 659 | 681 | 702 | 720 | 734 |
| Debt service (in US$ millions) 1/ | 9.7 | 8.9 | 7.3 | 7.5 | 7.7 | 8.1 | 8.7 | 9.6 | 10.6 | 11.5 |
| 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 7. Solomon Islands: Alternative Policy Action Scenario

| | 2017 | 2018 | 2019 | 2020 | Fiscal Measures |
|---|---|---|---|---|---|
| **Revenue** | **0.3** | **0.85** | **0.85** | **0.85** | |
| Tax Revenue | 0.3 | 0.85 | 0.85 | 0.85 | |
| Income and profits | 0.05 | 0.10 | 0.10 | 0.10 | Reducing tax exemptions and improving administration and compliance |
| Reducing stock of tax arrears | 0.20 | 0.70 | 0.70 | 0.70 | Reducing stock of tax arrears: reduce outstanding cases by 5 percent by end June 2018<br>Reducing outstanding returns on hand by 15 percent by end June 2018<br>Strengthening timeframe for prosecution by December 2017 |
| International trade and transactions | 0.05 | 0.05 | 0.05 | 0.05 | Tax reference price for logs should be in line with world market prices |
| **Expenditure** | **-0.40** | **-0.90** | **-0.90** | **-0.90** | |
| Recurrent spending | -0.10 | -0.35 | -0.35 | -0.35 | |
| Compensation of employees | -0.05 | -0.10 | -0.10 | -0.10 | Containing wage bill growth below the nominal GDP growth |
| Other recurrent spending | -0.05 | -0.25 | -0.25 | -0.25 | Reducing spending for scholarships and travel with 2017 Budget review and 2018 Budget |
| Development spending | -0.30 | -0.55 | -0.55 | -0.55 | |
| CDFs | -0.10 | -0.20 | -0.20 | -0.20 | Reducing CDFs, publish a supplement on CDFs planning, use of funds in 2018 Budget |
| Other development spending | -0.20 | -0.35 | -0.35 | -0.35 | Prioritizing and streamlining development spending: reducing shipping grants |
| **Total Savings** | **0.70** | **1.75** | **1.75** | **1.75** | |
| Cumulative Savings | 0.70 | 2.45 | 4.20 | 5.95 | |
| Adjustment Scenario | | | | | |
| Overall Balance (In percent of GDP) | -3.4 | -3.9 | -2.1 | -1.7 | |
| Cash Balance (in SI$ millions) | 164 | 293 | 369 | 551 | |
| in months of recurrent spending | 0.8 | 1.3 | 1.5 | 2.2 | |
| Broader Cash Balance (in SI$ millions) | 304 | 434 | 510 | 692 | |
| in months of total spending | 1.0 | 1.3 | 1.5 | 2.0 | |
| Public Debt (In percent of GDP) | 10.0 | 14.6 | 16.4 | 18.6 | |
| Memorandom items: | | | | | |
| Overall Balance (In percent of GDP, baseline) | -4.1 | -5.7 | -3.9 | -3.5 | |
| Public Debt (In percent of GDP, baseline) | 10.0 | 14.6 | 16.4 | 18.6 | |

Source: Staff estimates

## Table 8. Solomon Islands: Comparison of Baseline and Alternative Policy Action Scenario

| | Baseline scenario | | | | Reform scenario | | | |
|---|---|---|---|---|---|---|---|---|
| | 2017 | 2018 | 2019 | 2020 | 2017 | 2018 | 2019 | 2020 |
| Real GDP growth (in percent) | 3.2 | 3.0 | 2.9 | 2.8 | 3.2 | 3.0 | 2.9 | 3.0 |
| CPI (period average, in percent)) | 1.0 | 1.2 | 2.0 | 2.7 | 1.3 | 0.9 | 2.0 | 2.7 |
| Total revenue and grants | 41.2 | 42.4 | 42.0 | 41.6 | 41.5 | 43.3 | 42.9 | 42.4 |
| Revenue | 31.7 | 31.5 | 31.4 | 31.2 | 32.0 | 32.4 | 32.3 | 32.1 |
| Grants | 9.5 | 10.8 | 10.6 | 10.3 | 9.5 | 10.8 | 10.6 | 10.3 |
| Total expenditure | 45.3 | 48.1 | 45.8 | 45.1 | 44.9 | 47.2 | 44.9 | 44.1 |
| Recurrent expenditure | 30.4 | 31.0 | 31.0 | 30.3 | 30.3 | 30.7 | 30.6 | 29.9 |
| Development expenditure | 14.9 | 17.1 | 14.9 | 14.7 | 14.6 | 16.5 | 14.3 | 14.2 |
| Overall balance | -4.1 | -5.7 | -3.9 | -3.5 | -3.4 | -3.9 | -2.1 | -1.7 |
| Broader cash balance (in months of total spending) | 1.0 | 0.7 | 0.3 | 0.2 | 1.0 | 1.3 | 1.5 | 2.0 |
| Central government debt | 10.0 | 14.6 | 16.4 | 18.6 | 10.0 | 14.6 | 16.4 | 18.6 |
| Current account balance | -4.4 | -5.0 | -6.4 | -6.8 | -4.4 | -5.0 | -6.4 | -6.8 |

Source: Staff estimates

# Appendix I. Solomon Islands: SDGs Identified in the 2016–35 National Development Strategy (NDS)

| Key development objectives identified by the NDS | Corresponding SDGs[1/] | | Role of the IMF |
|---|---|---|---|
| Sustained and inclusive economic growth | 5 Gender Equality<br>8 Inclusive Economic Growth & Decent Work | 9 Resilient Infrastructure & Innovation<br>10 Reduced Inequality | ✓ Analytical work on public investment<br>✓ TA on domestic revenue mobilization<br>✓ TA on financial stability to support financial deepening and inclusion |
| Poverty alleviation | 1 No Poverty<br>2 Zero Hunger | 6 Clean Water & Sanitation | ✓ Surveillance and policy advice on macro-economic policies |
| Access to quality social services | 3 Good Health and Well Being<br>4 Quality Education | | ✓ Coordination with the World Bank Group and development partners |
| Resilient and environmental sustainable development | 7 Affordable and Clean Energy<br>11 Sustainable Cities & Communities<br>14 Sustainable Use of Oceans | 12 Responsible Consumption<br>13 Climate Action<br>15 Protect Forests & Ecosystem | ✓ Provide analytical and policy framework on how to incorporate the cost of natural disasters and climate change<br>✓ Capacity development |
| Stable and effective governance and public order | 16 Peace, Justice, and Strong Institution | 17 Partnerships for the Goals | ✓ TA on PFM with a particular focus on improved medium-term revenue and expen- diture forecasting; stronger integration of planning and budgeting within a medium-term framework |

1/ Staff compilation.

# Appendix II. Solomon Islands: Authorities' Response to Fund Policy Advice

See IMF Country Report No. 16/90, MEFP Table

| Fund Recommendation | Policy Actions |
|---|---|
| **Fiscal Policy** | |
| Maintain adequate fiscal buffer | The government's "program" cash balance (a performance criterion under the ECF) fell from the equivalent of 3.6 months of recurrent spending at end-2015 to 2.0 months at end-2016. The broader cash balance, which was recommended to be maintained at 2 months of total spending, fell to 1.6 months as of July 2017. |
| Increase fiscal openness, transparency and planning | The 2017 budget documents have yet to be published on the website, although they are available on request. The Public Financial Management Act 2013, requires budget documents to be published. |
| 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. It is currently being reviewed by the ADB and will then be sent to the Attorney-General's Chambers for vetting. There is not yet a firm timeline for presenting the bill to Parliament. |
| Promote transparency and accountability of public funds | In March 2017, the Solomon Islands Tertiary Education and Skills Authority Act was promulgated by Parliament, providing among others, a transparent set of criteria for the award of tertiary scholarships, partially implementing an unmet structural benchmark under the ECF. However, the long-completed report on the 2012 audit of the Constituency Development Funds (CDFs) has not been published and no further audits of CDF activity have been conducted. |
| 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. However, the government increased a limit for the public debt-to-GDP ratio by five percentage points to 30 percent. It also increased the annual borrowing limit from SI$300 million in 2016 budget to SI$900 million in 2017 budget. |
| **Monetary and Financial Sector Policy** | |
| Strengthen supervisory and regulatory framework for the financial system | The Cabinet has 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 November 2017, no further progress has been made in tabling the bills in 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. |
| **Exchange rate policy and external policy buffer** | |
| Follow the basket peg more closely, including by widening the operational ±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. |
| **Structural Reforms** | |
| 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, with work on the project expected in 2018/19 and the plant slated for operations in 2022, and is expected to reduce the cost of electricity. |
| 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 III. Solomon Islands: Medium- and Long-Term Growth Assumptions

**Medium term**. Real GDP growth is projected at 2.9 percent on average during 2017–2022 reflecting the net impact of three factors—(i) a push for higher infrastructure spending, offset by: (ii) continuing public financial management problems which have resulted in domestic arrears and are impeding private sector activity, and (iii) flat logging production.

**Long term**. The starting point for the long-term (2023–37) real GDP growth projections is the historical average growth for Solomon Islands after the end of The Tensions, which is 4.6 percent. However, this included growth spurts driven by spikes in short-lived gold production. The projections adjust for this temporary upside by eliminating years with growth rates more than one standard deviation from the mean, while retaining the years where growth performance is more than one standard deviation below to take into account downside risks. This yields average growth of 3.7 percent. Factoring in UN projections of slowing population growth moderates this to 3.5 percent. For the purposes of the DSA, a further 0.3 percentage points is shaved off to reflect natural disaster risks, thus bringing long-term growth to 3.2 percent during 2023–37. Growth is higher in the long term than the medium term supported by (i) further infrastructure development to close the severe infrastructure gap; (ii) coming on stream of sustained mining activity in gold, nickel, and bauxite; and (iv) a boost from efforts to improve financial inclusion and promote growth in agriculture, tourism and manufacturing.

**Solomon Islands: Long-Term Real GDP Growth (2004–15)**

| | Total Average | Average without outliers | Average without upside outliers | Standard deviation | Upper outlier-cutoff | Lower outlier-cutoff |
|---|---|---|---|---|---|---|
| Real GDP growth (in percent) | 4.6 | 4.3 | 3.7 | 3.1 | 7.7 | 1.4 |

Sources: Solomon Islands National Statistical Office, IMF staff calculations.

# Appendix IV. Risk Assessment Matrix 1/

| Likelihood | Impact | | Policy Response |
|---|---|---|---|
| Medium / Low | **High**<br>**1. Reopening of Gold Ridge mine and beginning of the nickel and bauxite projects**<br>Production of mining would contribute to export growth and revenue increase.<br>**2. Positive spillovers from large infrastructure projects**<br>The implementation of the long-standing plans for large infrastructure projects, such as the Tina Hydropower development project and the undersea cable project, could have positive spillovers on the economy from 2018 onwards. | **Upside** | • Take advantage of upside surprises to lock in an improvement in fiscal buffers.<br>• Ensure these new sources of growth are taxed properly.<br>• Consider ways to use some of the gains to invest in resilient infrastructure. |
| Low | **Medium**<br>**3. Lower oil prices**<br>Persistently lower oil prices have kept inflationary pressures in check and deflationary pressures have been limited. | **Upside** | • Take advantage of favorable conditions to make fiscal adjustment and buy time for structural reforms to yields results. |
| High | **High**<br>**1. Fiscal policy slippage**<br>Expansionary fiscal policy and weak public financial management increase domestic arrears, resulting in a rise in non-performing loans in the banking sector. | **Downside** | • Put in place a plan to eliminate domestic arrears.<br>• Consider additional measures to contain discretionary spending.<br>• Redouble efforts to contain spending on CDFs, tertiary scholarships and shipping grants. |
| Low | **High**<br>**2. Security risk**<br>Security risk may increase in the run-up to the general election, which is expected to be held in early 2019. | **Downside** | • 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.<br>• Continue to push forward with the anti-corruption strategy. |
| Medium | **High**<br>**3. Weaker-than-expected global growth, especially significant China slowdown and its spillovers.**<br>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. | **Downside** | • Use policy buffers, including international reserves, to cushion the impact. Seek additional concessional financing to ensure that critical capital expenditure projects can continue.<br>• Over time, diversify sources of growth. |
| High | **Medium**<br>**4. Tighter or more volatile global financial conditions:**<br>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. | **Downside** | • 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. |
| High | **Medium**<br>**5. Reduced financial services by correspondent banks (de-risking)**<br>The global risk of loss of correspondent banking relationships is high (hence the high likelihood). However, this may affect Solomon Islands somewhat less than other Pacific Islands as Solomon Islands has a low level of remittances—nonetheless it is not an insignificant risk and it could have a significant impact on financial inclusion and result in higher remittance costs. | **Downside** | • Upgrade regulatory and supervisory frameworks to comply with international standards regarding both AML/CFT and tax transparency. |
| High | **High**<br>**6. Natural disasters and climate change**<br>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 a sea-level rise caused primarily by global warming. | **Downside** | • Build fiscal buffers against a natural disaster shock.<br>• 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.<br>• Invest in resilient infrastructure to strengthen climate change mitigation and adaptation. |

1/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 V. Financial Inclusion: A Tailored Approach for Solomon Islands and the Role of Fintech[1]

## A. Financial Inclusion Amid Geographical and Financial Development Challenges

1. **Solomon Islands' financial sector development lags peers.** Financial sector development in Solomon Islands is impeded by the same physical and structural challenges that affect the real economy: a small population; geographical dispersion, and distance; inadequate infrastructure, and higher risk premium/transaction costs due to the high vulnerability to natural disasters. Even after taking into account these challenges, the size of the financial sector is appreciably below small states and Pacific island countries averages.

2. **Solomon Islands' financial sector development is also below potential.** Comparing the size of Solomon Islands' financial sector against a benchmark implied by its economic development, size of the economy, poverty level, and potential for diffusion of financial services—measured by GDP per capita income, population, poverty gap, and population density, respectively—suggests subpar performance. The level of financial sector development, for instance, as measured by credit activity relative to the size of the economy, is significantly below the financial possibility frontier implied by the underlying economy.[2] The gap between the financial possibility frontier and actual attainment has grown steadily in recent years.

3. **Limited financial development has resulted in limited financial inclusion, which is further exacerbated by geographical challenges**. Capacity constraints have hindered efforts to foster financial literacy, while inadequate infrastructure has impeded wider access to financial services. The physical access to financial services—e.g. number of bank branches and ATMs relative to population and land area— is also low relative to peers, partly due to geographical dispersion.[3] As of 2015, a financially excluded Solomon Islander lived an average of 6.2 hours from the closest bank branch, while a person with a bank account would have to travel two hours. For the unbanked, the average cost of getting to a bank branch was US$13.00, an exorbitant amount in a country where GNI per capita per day stood at US$4.40.[4] Solomon Islands also trails many comparators in terms of the number of deposit accounts and borrowers per capita.

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[1] Prepared by Fazurin Jamaludin, Irene Zhang provided excellent assistance.

[2] Benchmark levels of financial development calculated based on "Benchmarking Financial Development" by Thorsten Beck, Erik Feyen, Alain Ize and Florencia Moizeszowicz, The World Bank, Policy Research Working Paper 4638, 2008. Instead of using the land area to calculate population density, we use the total area (including intervening bodies of water) to better reflect the challenges posed by wide geographical dispersion to market access.

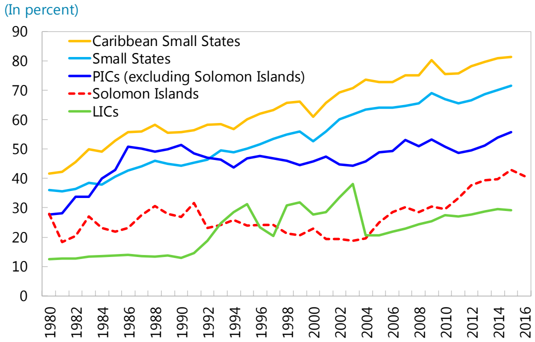
[3] See for instance, "Financial Inclusion: Can It Meet Multiple Macroeconomic Goals?" by Ratna Sahay, Martin Čihák and others, International Monetary Fund, Staff Discussion Note 15/17, 2017

[4] "National Demand-Side Survey to Assess the Access and Usage of Financial Services and Products in the Solomon Islands," Bankable Frontier Associates, 2015

## Figure 1. Solomon Islands: Financial Sector Development and Inclusion

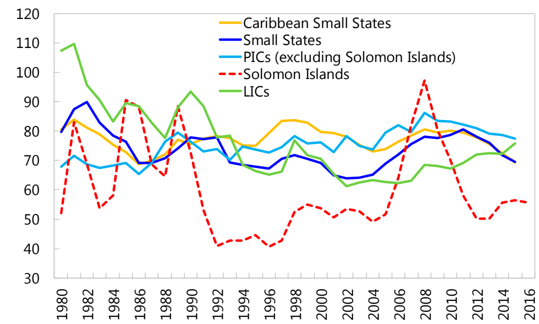
*The size of Solomon Islands' financial sector as measured by the relative levels of deposit…*

**Domestic Bank Deposits to GDP**
(In percent)



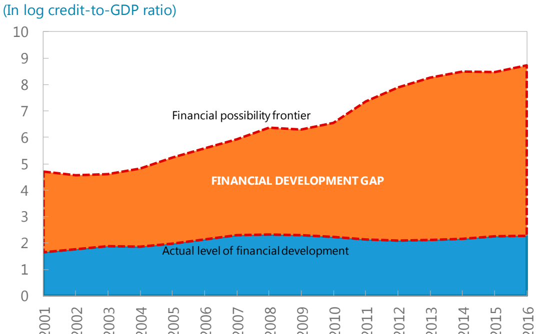

*…and credit is below small states and Pacific island countries averages*

**Private Credit to Deposits**
(In percent)




*…with the level of financial sector development likely below potential.*

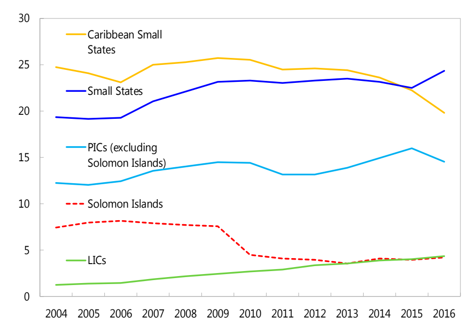
**Solomon Islands: Financial Development Gap**
(In log credit-to-GDP ratio)




Sources: IMF staff calculations based on Thorsten and others (2008).

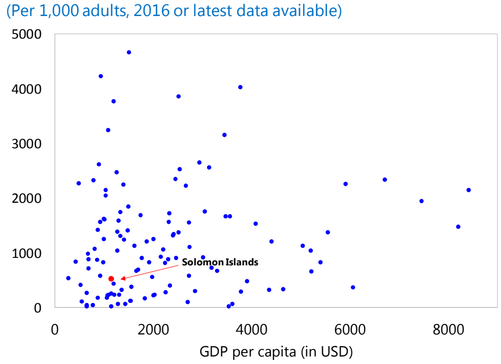
*Financial inclusion also lags many comparators in terms of physical access…*

**Number of Branches, Commercial Banks**
(per 100,000 adults)



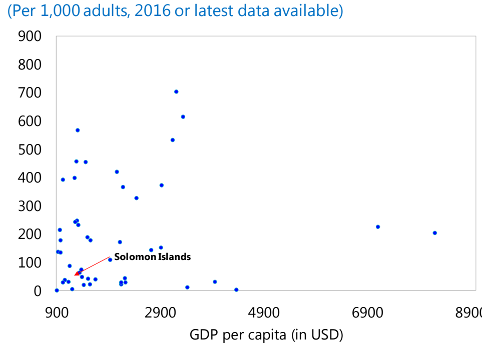

*…number of bank accounts…*

**Deposit accounts with commercial banks**
(Per 1,000 adults, 2016 or latest data available)




*…and access to credit, especially when compared to many countries at similar income per capita levels.*

**Borrowers at commercial banks**
(Per 1,000 adults, 2016 or latest data available)




Sources: FinStats 2017, IMF staff calculations based on Thorsten and others (2008).

## B. Progress on Financial Inclusion and the Role of Fintech

**4. Despite lagging comparators, Solomon Islands has recently made important strides in financial inclusion.** In 2010, the Central Bank of Solomon Islands (CBSI) estimated that as many as 85 percent of the population were excluded from the financial system. As at the end-2015, the percentage of financially excluded Solomon Islanders has fallen to around 35 percent.[5] During 2011-15, a total of 78,000 individuals were added to the formal financial system (target: 70,000).

**5. A clear policy direction has been critical.** With the launch of National Financial Inclusion Strategy 2011–15 (NFIS1)—spearheaded by the CBSI—Solomon Islands emerged as a pioneer among Pacific island countries in charting a roadmap for financial inclusion, incidentally becoming the first country in the world to integrate targets for women in its national financial inclusion strategy.[6] NFIS1 led to the formation of the National Financial Inclusion Taskforce (NFIT), comprising representatives of the central bank, the government, commercial banks, the private sector and NGOs, to facilitate coordination and collaboration on financial inclusion among key stakeholders.

**6. Solomon Islands has identified fintech as a key component of its national financial inclusion strategy, given the physical barriers to access.** NFIS1 explicitly identified increasing financial digital services as one of three areas of focus in fostering financial inclusion. During 2011-16, financial access points rose significantly in number, driven by a brisk expansion of an EFTPOS-supported branchless banking network as well as mobile banking services.[7] All in all, financial access points in Solomon Islands excluding ATMs and bank branches increased by over 300 percent during this period.[8] NFIS2 has further included amplifying "the reach and quality of digital financial services" as one of its six strategic objectives (see below).

**7. Solomon Islands has leveraged wider access to mobile phones to support greater financial access.** Increased competition following the entry of a second mobile network operator in 2010 spurred greater investment in telecommunications infrastructure, enabling wider adoption of mobile banking. As at end-2014, around half of the population had access to mobile phones.[9] The mobile banking was launched towards the end of 2013, and has grown since then.[10] To facilitate the adoption of mobile banking, the CBSI started licensing mobile banking agents: as at end-2015, Solomon Islands had one of the highest ratios of active mobile banking agents relative to its population in the Pacific.

[5] "National Demand-Side Survey to Assess the Access and Usage of Financial Services and Products in the Solomon Islands", Bankable Frontier Associates, 2015

[6] "Solomon Islands National Financial Inclusion Strategy II (NFIS2) 2016–20", Solomon Islands National Financial Inclusion Taskforce, 2016

[7] Electronic Funds Transfer at Point of Sale, a payment system enabling electronic transfers of funds at payment terminals.

[8] *2016 CBSI Annual Report*, Central Bank of Solomon Islands, 2017

[9] "The Mobile Economy: Pacific Islands 2015", GSM Association, 2015

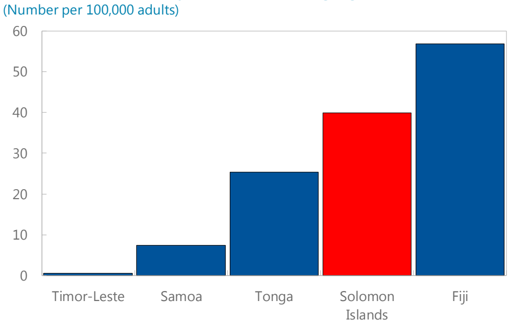
[10] *Go Money*, introduced by ANZ, an Australian bank. Mobile *banking* is distinct from mobile *money* (or mobile wallet). The former is currently available in Solomon Islands since 2013 while the latter was only introduced recently. Mobile banking requires an underlying bank account; mobile money transactions do not. M-PESA and similar services in Kenya and Tanzania are examples of mobile money services.

**8. Mobile banking has grown in volume and value**. As of 2015, an estimated 40 percent of adults with a banking account had access to mobile banking. In the same year, Solomon Islanders conducted at least seven times more mobile banking transactions on average than their Pacific island and small states counterparts. While the value of mobile banking activity relative to the size of the economy is minuscule—transaction balances and value were below 4 percent of GDP in 2016—both have trended upwards. Falling numbers of EFTPOS terminals and merchants also suggest a shift in customers' preferences towards mobile banking (Table 1).

**9. Mobile banking has facilitated domestic remittances.** A 2015 demand-side financial inclusion survey shows that apart from the relatively basic functions of checking account transactions and topping up mobile phone credit balances, the top three uses of mobile banking involved sending or receiving money domestically, with almost one-fifth of mobile banking customers doing so.[11] While mobile banking only accounted for 5 percent of domestic remittances in 2015, the growth potential is significant (see below).

**Solomon Islands has leapfrogged peers in mobile banking infrastructure…**

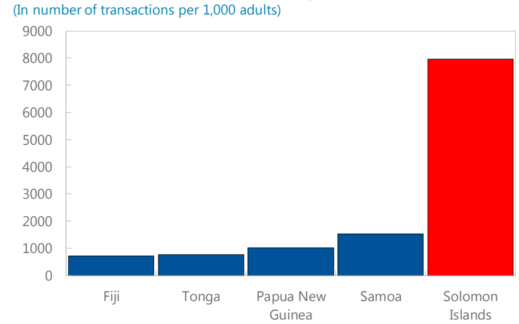
**Active mobile money/mobile banking agents, 2015**
(Number per 100,000 adults)




Sources: IMF Financial Access Survey

**…and in number of transactions relative to its population.**

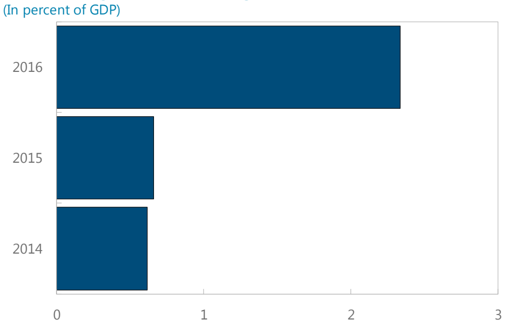
**Number of mobile money/banking transactions, 2015**
(In number of transactions per 1,000 adults)




Sources: IMF Financial Access Survey

**Although the total value of mobile banking activity is small relative to the size of the economy…**

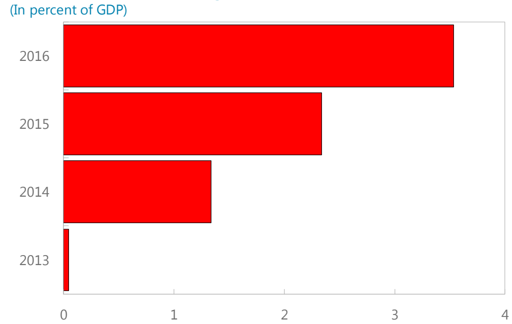
**Outstanding mobile banking account balance**
(In percent of GDP)




Sources: IMF Financial Access Survey; IMF staff calculations.

**… it has grown steadily.**

**Value of mobile banking transactions**
(In percent of GDP)




Sources: IMF Financial Access Survey; IMF staff calculations.

[11] "National Demand-Side Survey to Assess the Access and Usage of Financial Services and Products in the Solomon Islands", Bankable Frontier Associates, 2015

**Table 1. Solomon Islands: Financial Access Points**

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|---|
| Commercial bank branches | 13 | 13 | 12 | 14 | 14 | 15 |
| ATMs | 38 | 38 | 38 | 39 | 41 | 42 |
| EFTPOS terminals | 175 | 224 | 306 | 346 | 400 | 310 |
| EFTPOS merchants | n.a. | n.a. | 72 | 325 | 353 | 256 |
| Mobile banking agents | n.a. | n.a. | 0 | 105 | 164 | 192 |

Source: Central Bank of Solomon Islands

## C. The Way Forward

**10. The National Financial Inclusion Strategy 2016–20 (NFIS2) provides a comprehensive roadmap for furthering financial inclusion.** NFIS2, issued in 2016, seeks to build on the progress made on increasing access, with a greater focus on usage and financial literacy. It aims to add 300,000 new users of formal and semi-formal financial services by 2020, of which half is targeted to be women. NFIS2 also leverages findings from studies and surveys of demand-side data to complement readily available supply-side data.

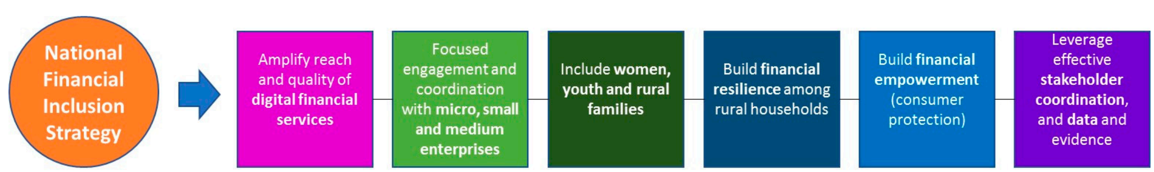
**11. NFIS2 identifies five key indicators and six strategic objectives that will be pursued through broad-based consultation and collaboration.** NFIS2 sets five targets to be achieved by 2020 that address issues of access, usage, credit and financial literacy. It further articulates action plans under six strategic objectives: (i) digital financial services; (ii) micro, small and medium enterprises; (iii) inclusion of marginalized groups; (iv) rural households' financial resilience; (v) consumer protection; and (vi) stakeholder coordination and leveraging data (Table 2 and Figure 1). NFIS2 also spells out the roles of key stakeholders—ministries, non-profits, banks, nonbanks, nonfinancial private sector players, and development partners.

**Table 2. Key Indicators Under National Financial Inclusion Strategy 2016–20**

| Area | Current status | Target |
|---|---|---|
| **Overall access** | 90 percent of the population live within 8 hours of nearest financial access point | 90 percent of the population live within 60 minutes of nearest financial access point |
| **Overall use** | 33.8 percent of adults have active formal/semiformal financial accounts | 70 percent of adults have active formal/semiformal financial accounts |
| **Formal credit** | 3.8 percent of adults have active formal/semiformal credit accounts | 10 percent of adults have active formal/semiformal credit accounts |
| **Financial literacy** | Continued monitoring of activity in savings clubs, and usage of savings and insurance services, as well as attendance of financial literacy programs | |
| **Savings club** | 5.3 percent of adults are members of saving clubs | 10 percent of adults are members of savings club |

Sources: Solomon Islands National Financial Inclusion Strategy 2016-20; IMF staff compilation

**Figure 1. Strategic Objectives Under National Financial Inclusion Strategy 2016–20**




Sources: Solomon Islands National Financial Inclusion Strategy 2016–20; IMF staff compilation.

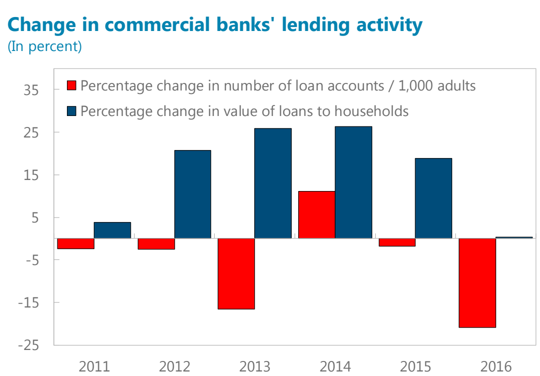
**12. The role of fintech-based solutions is likely to grow.** Mobile broadband penetration in the Pacific island countries is expected to rise to 42 percent by 2020 (2014: 17 percent), and in Solomon Islands, smartphone adoption is projected to rise to 57 percent (2014: 24 percent).[12] The 2015 demand-side survey also shows that *more than two-thirds* of domestic remittances occurred *in cash*, with money being *transmitted physically* by relatives or acquaintances. The high cost and inconvenience of cash transfers imply greater use of mobile phone-based remittances. Fintech use will also grow with the introduction of mobile money products—including savings products—and will extend beyond financial access-specific initiatives, as exemplified by the pilot on-line taxation system conducted under the Pacific Financial Inclusion Programme.

**13. Solomon Islands should leverage development partners' expertise and other countries' experience in further development of fintech.** With the envisaged involvement of nonbanks, including mobile network operators, other IMF members' experience in choosing a workable regulatory approach could be instructive.

**14. Remaining challenges include broadening credit access and maintaining usage.** Starting from a low base, credit growth has been brisk, with the growth of commercial banks' loans to the private sector hitting double digits in the last five years. Most of this activity has been driven by strong credit growth to households. However, this has not been matched by the number of loan accounts per head, suggesting that borrowing has been concentrated to a relatively small portion of the population. Separately, maintaining the momentum in the rate of usage of mobile financial services will be crucial and will depend on spreading the financial literacy program.

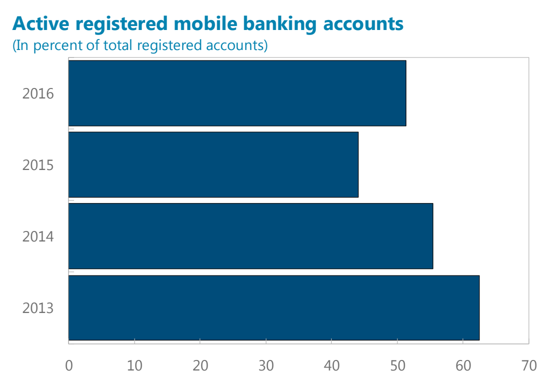
**15. As mobile payments develop, the CBSI will need to extend the scope of its supervision.** The CBSI has developed a Practice Guidance note "Use of cash agents in Solomon Islands" which addresses the matters banks should focus on in selecting, assessing and contracting with the agents they use to deliver mobile payment services. The Outsourcing Prudential Guidance is currently in draft form, but once it is finalized, it should be referenced in relation to the provision of mobile payments and the interaction between banks and its agents. With the growth of mobile payments accelerating, the CBSI should start assessing the risk of mobile payments to financial institutions and their management of those risks, as part of the regular supervision processes.

**Bank lending to households has not moved in tandem with credit access per capita**




Sources: IMF Financial Access Survey; IMF staff calculations.

**Maintaining the level of usage of mobile banking will be a key challenge going forward**




Sources: IMF Financial Access Survey; IMF staff calculations.

[12] "The Mobile Economy: Pacific Islands 2015", GSM Association, 2015

INTERNATIONAL MONETARY FUND

# SOLOMON ISLANDS

January 4, 2018

## STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | Asia and Pacific Department (In consultation with other departments)

## CONTENTS

# FUND RELATIONS

(As of November 30, 2017)

**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 | 1.40 | 14.12 |

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

| | SDR Million | Percent of Quota |
|---|---|---|
| ECF Arrangements | 1.04 | 5.00 |
| SCF Arrangements | 4.51 | 21.67 |

**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:**[1]
**(SDR Million; based on existing use of resources and present holdings of SDRs):**

| | | | .....Forthcoming | | |
|---|---|---|---|---|---|
| | **2017** | **2018** | **2019** | **2020** | **2021** |
| **Principal** | **1.04** | **2.46** | **1.46** | **0.13** | **0.19** |
| **Charges/Interest** | **0.01** | **0.01** | **0.04** | **0.04** | **0.04** |
| **Total** | **1.05** | **2.46** | **1.51** | **0.18** | **0.24** |

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

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

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

**Implementation of 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 ±20 and ±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 2016 Article IV Consultation discussions were held in Honiara during January 19–28, 2016. The staff report (IMF Country Report No. 16/90) was considered by the Executive Board and the consultation concluded on March 21, 2016.

**Technical Assistance:**

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

| Date | Department | Purpose |
|---|---|---|
| February 2007 | PFTAC | Balance of Payments Statistics |
| February and November 2007 and May 2008 | PFTAC | National Income Accounts |
| March 2007 and March 2008 | MCM | Accounting |
| February 2008-February 2009 | STA | Peripatetic Export and Import Price Index Statistics |
| February-March 2008 | PFTAC and FAD | Tax Policy |
| April 2008, February 2009 | PFTAC | Balance of Payments Statistics |
| June 2008 | LEG | Review of Central Bank Act |
| April 2008-April 2009 | MCM | Peripatetic Advisor to CBSI |
| June 2008, September 2008, June 2009 | MCM | Monetary Operations and Liquidity Management |
| July 2008 | STA | Money and Banking Statistics |
| January 2009, April 2010, April 2011 | STA | Monetary and Financial Statistics |
| April 2009 | MCM | Insurance Supervision |
| June 2009 | LEG | Insurance Sector Law |
| June 2009 | MCM | Central Bank Law |
| April 2010 | PFTAC | Balance of Payment Statistics |
| April 2010, May 2011 | PFTAC | National Account Statistics |
| September 2010 | PFTAC | Government Finance Statistics |
| June 2010, October 2010, March 2011 | PFTAC | Financial Supervision |
| October 2010, March 2011 | FAD, PFTAC | Natural Resource Tax Policy |
| October 2010, June 2011 | MCM | Monetary Operation and Liquidity Management |
| July 2010, October 2010, January 2011 | PFTAC | Public Financial Management |
| April 2011 | FAD | Budget Law |
| April 2011 | PFTAC | Macroeconomic Advisor Visit |
| April 2011 | STA | GDDS Metadata Development |
| July 2011 | PFTAC | Customs Administration |
| September 2011 | LEG | Tax Legislations |
| November 2011 | MCM | Exchange Rate Flexibility and Foreign Exchange Market Development |
| February 2012 | STA | Consumer Price Index |
| June 2012 | FAD | Public Finance and Audit Act |
| September 2012 | STA | Monetary and Financial Statistics |
| January 2013 | LEG | Financial Institutions Act |
| March 2013, September 2013 | STA | External Sector Statistics |
| May 2012, May 2013 | MCM | National Provident Fund |
| February 2013, August 2013 | PFTAC | National accounts |
| November 2013 | PFTAC | PFM law and the Constituency Development Fund Law |
| December 2013 | PFTAC | PFM Roadmap Development Guidance – Phase I |
| March 2014 | STA | Balance of payments statistics |
| March 2014 | PFTAC | Non Tax Review and National Accounts |
| July and October 2014 | PFTAC | Develop Macro Framework |
| August 2014 | PFTAC | National Accounts |

| Date | Department | Purpose |
|---|---|---|
| September 2014 | MCM | Enhancing the effectiveness of monetary policy and exchange rate regime |
| September 2014 | PFTAC | PFM Roadmap Implementation |
| October 2014 | FAD | Implementing the new mining tax regime |
| October 2014 | PFTAC | Non Tax Review introductory mission |
| November 2014 | STA | External sector statistics |
| March 2015 | MCM | Improving the monetary transmission mechanism |
| April 2015 | STA | Monetary and financial statistics |
| May 2015 | PFTAC | Support 5th ECF Review |
| June 2015 | PFTAC | Training on FP Framework to assess debt sustainability |
| August 2015 | MCM | Evaluation of TA needs on banking supervision |
| August 2015 | PFTAC | Financial Supervision |
| May 2015 | STA | Government finance statistics |
| August, September 2015 | STA | Government finance statistics |
| October 2015 | STA | Balance of payments statistics |
| January 2016 | PFTAC | Support the 2016 Article IV Consultation and 5th and 6th ECF Reviews |
| February 2016 | PFTAC | Credit Union Program |
| February 2016 | PFTAC | National Accounts |
| July 2016 | PFTAC | National accounts |
| September 2016 | PFTAC | Government finance statistics |
| October 2016 | MCM | On-site examination of SINTACUL |
| January 2017 | FAD | Revenue Mobilization Diagnostic |
| March 2017 | PFTAC | Macroeconomic and fiscal framework, and gross domestic product and revenue forecasting |
| March 2017 | PFTAC | Government finance statistics |
| May 2017 | PFTAC | Cash management and public financial management |
| May 2017 | PFTAC | Tax debts |
| August 2017 | PFTAC | Diagnostic mission on bank supervision |
| September 2017 | MCM | Reserves management |

**Resident Representative**: The resident representative office in the Pacific Islands was opened in September 2010 in Suva, Fiji. Mr. Tubagus Feridhanusetyawan is the current Resident Representative.

# SUPPORT FROM THE PACIFIC FINANCIAL TECHNICAL ASSISTANCE CENTRE[1]

**Solomon Islands: PFTAC Country Strategy 2017–18**

**Background**

Solomon Islands has made considerable gains in establishing macroeconomic stability and strengthening institutions in the past six years. Growth has been solid and international reserves are at comfortable limits However, Solomon Islands faces numerous challenges common to many small states in the Pacific—it is remote, highly vulnerable to natural disasters and climate change, has a narrow production base, a large infrastructure gap, and administrative capacity constraints. The government is gearing up for elections in early 2019 and the fiscal position has deteriorated. The reform agenda, amongst other things, emphasizes strengthening of public financial management, revenue mobilization, financial sector supervision and macro-economic statistics.

**Solomon Islands has been a significant user of PFTAC TA**, being the third and fourth largest recipient of PFTAC support in FY17 and FY18 respectively. PFM focus has been on finalizing and rolling-out the PFM roadmap, with more recent emphasis on strengthening cash management. A recently launched government tax review is expected to impact significantly on future PFTAC revenue support depending on policy options considered. Financial sector assistance is focused on a prudential supervision framework. In statistics, considerable TA has been provided to build GDP compilation capacity and recent missions have supported work to rebase GDP from 2004 to 2012. Significant amounts of support have been provided to CBSI in formulating and implementing new prudential regulations for banks and in developing inflation forecasting and a macroeconomic programming framework.

**PFTAC's TA strategy is guided by the APD regional strategy note and is planned within the Results-Based Management (RBM) framework for the current PFTAC funding cycle.**

In the **Public Financial Management** area, following on the results from the 2012 PEFA, the focus of PFTAC TA in the last two years was in preparation of the PFM Roadmap and assisting with the delivery of awareness and advocacy seminars for key stakeholders. For FY18, PFTAC TA focuses on cash management reform. Assistance is also anticipated to update Finance Instructions based on the 2013 PFM Act. In the medium-term, PFTAC is ready to support other reforms such as improving fiscal oversight of state-owned enterprises, and improving budget documentation.

In the **revenue** area, the Finance Minister recently approved the launch of a Tax Review as part of the Government's fiscal reforms. The tax review will be undertaken in stages over three years and includes: (1) a review of tax administration and consumption taxes; (2) a review of income tax; and (3)

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

a review of other taxes. Stage one public consultations have already commenced and are being facilitated through a consultative committee which includes representatives from the private sector, civil society, Inland Revenue, and Customs. On the operational front PFTAC assisted in the design of a strategy aimed at strengthening on-time filing, payment of tax arrears, and securing outstanding returns. Although some progress has been made the authorities have requested additional TA to facilitate implementation. TA previously provided by New Zealand's Inland Revenue is currently being phased out which may necessitate PFTAC playing a bigger future role in modernizing revenue administration.

In **financial sector supervision**, PFTAC and the CBSI recently conducted a diagnostic of the structure and operation of the CBSI's prudential supervision framework with the intention to commence a supervision framework enhancement program to improve the operational efficiency and effectiveness of the CBSI's supervision. The proposed program will focus TA over the next few years on key areas of supervision: prudential standards, off-site risk analysis, risk-rating and supervisory action planning. PFTAC has also assisted the CBSI in its ongoing credit union supervision work.

In **statistics**, PFTAC has provided more frequent assistance to the NSO in recent years, successfully building independent, local capacity. The coverage and timeliness of data obtained from the business survey and administrative sources, including GFS and overseas aid, have also been improved. Three missions in 2016/2017 assisted with rebasing GDP from 2004 to 2012; draft results are still under review by the NSO but are due to be published by end-2017. PFTAC is sharing rebasing findings with the Australian Bureau of Statistics, which is developing broader, reweighted CPI measure. Future work will focus on improving business survey processing and expanding data sources. Through October 2015 the Solomon Islands received technical assistance on GFS under the IMF HQ Japan Administered Account. Since the completion of this program, PFTAC started to support capacity development in GFS. Improvements were made by reconciling administrative data with GFS data for the budgetary central government. PFTAC's support aims at expanding coverage and compiling GFS for the general government in the Solomon Islands. PFTAC is funding an ESS TA mission later in FY17.

In the **macroeconomic** area, PFTAC is continuing to support the development and use of a macroeconomic programming framework involving staffs from both the Ministry of Finance and CBSI. Going forward, the task is to progress debt sustainability analysis, which is an important tool for evaluating and assessing the long-run impact of government policies. Support is also being provided to assist in the construction of quarterly GDP and an output gap measure to gauge inflationary pressures in the economy.

# RELATIONS WITH THE WORLD BANK GROUP

(As of October 2017)

The Bank and the Fund teams led by Mr. Robert Utz (Lead Economist and Program Leader, World Bank Sydney Office) and Mrs. Alison Stuart (IMF Mission Chief for Solomon Islands) maintain a regular dialogue on macroeconomic and structural issues, as do their respective technical teams. In recent years, collaborative efforts have focused on the joint Bank-Fund Debt Sustainability Analysis and regular discussions during missions and at headquarters. Visiting IMF missions regularly meet Bank staff in their Honiara office, led by Mr. Guido Rurangwa (World Bank Country Representative for Solomon Islands and Vanuatu), and at headquarters.

The teams agree that the key priorities for Solomon Islands include consolidating the recent improvement in the country's macroeconomic framework in the face of ongoing susceptibility to volatility in external conditions. The teams also agree that, in the context of continued heightened levels of realized and planned government spending, there is need to improve the quality of public spending to ensure public resources support the access to basic social services, improve the investment climate to support business development, and ensure state-owned enterprises can sustainably provide public services.

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

The Bank and Fund teams agree that the focus has shifted from post-conflict recovery to the medium-term reform and growth agenda—particularly in the face of a likely decline in log output. Priority issues include developing a more coordinated and prioritized approach to weaknesses in public financial management systems and ensuring that the reforms achieved to date are sustained and become regular practice, identifying policy reform priorities for fostering inclusive growth, reducing hardship and increasing resilience to climate change, ensuring budget allocations are better aligned with needs to achieve the priority of improving delivery of social services, and of strengthening the climate for investments, particularly in the mining sector. Between the Bank and the Fund, the Bank takes the lead in public expenditure management framework and structural reform issues, and the Fund will continue to take the lead on macro issues.

The Banks and Fund teams agree to continue close collaboration, mainly with regular contact through the Bank's Honiara and Sydney offices, the IMF regional resident representative office in Suva, and at headquarters. The Fund will also continue to collaborate with the broader development partner community. Appendix I provides a list of planned activities in the coming year.

## Bank and Fund Planned Activities

(January-December, 2017)

| | Activities | Expected Delivery Date |
|---|---|---|
| **World Bank** | • Programmatic support for mining sector governance (TA) | FY 18 (ongoing) |
| | • Advisory and analytical support to the Solomon Islands Statistics Office for the 2013 HIES | FY 16 (Completed) |
| | • Supporting Solomon Islands EITI implementation (TA) | FY 16 (completed) |
| | • Health sector public financial management support (Analytic and TA) | FY 18 (ongoing) |
| | • Solomon Islands Public Sector Governance Analytics (TA) | FY 18 (ongoing) |
| | • National Education Action Plan Costing (TA) | FY 15 (completed) |
| | • Core Economic Working Group policy dialogue, supporting a new series of Development Policy Operations | FY 16 (completed) |
| | • Pacific Tuna Advisory project IFC TA | FY 17 (ongoing) |
| | • Pacific Credit Bureau Phase 2 IFC TA | FY 16 (completed) |
| | • Pacific Investment Climate Rapid Response IFC TA | FY 16 (completed) |
| | • BSP/ANZ Solomon Rural Banking IFC TA (completed) | FY 16 (completed) |
| | • NPF Capex IFC investment | FY 17 (ongoing) |
| | • Pacific Gender Program IFC TA | FY 17 (ongoing) |
| | • Pacific Tourism Program IFC TA | FY 18 (planned) |
| | • PACER Plus implémentation support IFC TA | FY 18 (planned) |
| | • Bina Harbour PPP IFC TA | FY 18 (planned) |
| **IMF** | • 2017 Article IV Consultation | September, 2017 |
| | • Technical assistance on new banking legislation on credit union supervision, including support in legal expertise in handling the public comments on the draft act, and finalizing the draft. | 2016–17 (ongoing) |
| | • Technical assistance on legal issues pertaining to insolvency and creditor rights | 2016–17 (ongoing) |

# RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of October 2017)

Since joining the Asian Development Bank (AsDB) in 1973, Solomon Islands has received 19 loan projects amounting to $123.42 million, 15 grant projects totaling $160.52 million, and 75 technical assistance projects totaling $31.2 million.

The Pacific Approach, 2016–20 serves as the operational framework of AsDB for the Pacific region and the overall country partnership strategy for the 11 smaller Pacific island countries, including Solomon Islands (referred to by AsDB as the "PIC-11").

The Pacific Approach outlines a three-pronged strategy that focuses on reducing costs, managing risks, and enabling value creation. These three strategic priorities are applicable to all Pacific Island countries and are especially relevant for the PIC-11. It is intended to be read in conjunction with the PIC-11 country operations business plans and associated country strategic analyses, as well as the regional operations business plan for the Pacific region.

AsDB's country operations business plan (COBP) for 2017–19 for Solomon Islands continues AsDB's support to three sectors: energy, public sector management, and transport. The COBP includes water and other urban infrastructure and services as a new sector for AsDB involvement.[1]

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

**Transport.** Building on AsDB's existing Transport Sector Development Project, AsDB is continuing to support a sector-wide approach to management and development of a multimodal transport system. AsDB's Sustainable Transport Infrastructure Improvement Program promotes transport sector development and provides funding to the national transport fund for investment and capacity development activities in line with the National Transport Plan, 2011–30.

**Public sector management.** In coordination with development partners, AsDB will continue supporting government-led public sector management reforms with policy-based programs. The main goal of AsDB's assistance in public sector management is to improve the enabling environment for private-sector led, inclusive growth and development. A fifth policy-based program grant has been programed by AsDB for 2018. This follows AsDB's program grants approved in 2010, 2011, 2013, and 2016.

**Energy.** AsDB support will complement the efforts of other partners in the energy sector. A project to build a small hydropower plant and increase access to modern energy services was approved in 2014, but implementation has been slow due to land ownership issues. A solar power development project was approved in 2016, and a new hydropower project is proposed for approval of AsDB financing in December 2017, to supplement financing from other partners.

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[1] https://www.adb.org/countries/solomon-islands/strategy

**Water and urban infrastructure.** This is a new sector AsDB is assisting in 2017. A project preparatory technical assistance was approved in 2017 to prepare an urban sector development project for approval in 2018.

In 2008, AsDB established a development coordination office in Honiara, to strengthen partnerships with the government, and to facilitate coordination with other stakeholders. In 2016, the office was upgraded to an AsDB Extended Mission, further strengthening AsDB's presence on the ground.

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

# STATISTICAL ISSUES

| I. Assessment of Data Adequacy for Surveillance |
|---|
| **General:** Data provision has some shortcomings, but is broadly adequate for surveillance. |
| **National Accounts:** Recent technical assistance (TA) from the Pacific Financial Technical Assistance Center has led to improvements in national accounts at constant and current prices. GDP estimates through 2014 on the production side and the expenditure side were released in January 2016, and PFTAC will now provide TA to assist with rebasing the constant price accounts to 2012. |
| **Price statistics:** 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. |
| **Government finance statistics:** Monthly fiscal data for the central government are published by the Ministry of Finance and Treasury (MOFT). The authorities have started collecting disbursement information on donors' grants, including those nonappropriated in the budget. Monthly public debt data are published, and the quality debt data has improved through better coordination between the MOFT and the Central Bank of Solomon Islands (CBSI). 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. |
| **Monetary and financial statistics:** The CBSI publishes monthly monetary and financial statistics (MFS) in summary form and reports data for the central bank, other depository corporations and other financial corporations to the IMF's Statistics Department using the standardized report forms (SRFs). An integrated monetary database meeting the monetary data needs of the CBSI, APD and STA is in operation. Financial soundness indicators are reported quarterly. |
| **External Sector Statistics:** The CBSI has been compiling quarterly balance of payment statistics (BPS) using its own survey since 2006. Compared to the previous method, which was based on foreign exchange transactions reported through the banking system, the newly compiled BPS has improved both coverage and data accuracy. However, these quarterly data have not yet been reported to the IMF's Statistics Department. Solomon Islands has been one of the beneficiaries of the Japan Administered Account (JSA) Project on the improvement of external sector statistics. A TA mission under this project was conducted in 2013, and 2014. The CBSI does not report the international investment position (IIP) because it currently does not have the capacity to compile such statistics. |

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

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

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

(As of December 2017)

| | Date of latest observation | Date received | Frequency of Data/7 | Frequency of Reporting/7 | Frequency of Publication/7 |
|---|---|---|---|---|---|
| Exchange Rates | Aug-17 | Sep-17 | D | W | D |
| International Reserve Assets and Reserve Liabilities of the Monetary Authorities/1 | Jun-17 | Sep-17 | M | M | M |
| Reserve/Base Money | Jun-17 | Sep-17 | M | M | M |
| Broad Money | Jun-17 | Sep-17 | M | M | M |
| Central Bank Balance Sheet | Jun-17 | Sep-17 | M | M | M |
| Consolidated Balance Sheet of the Banking System | Jun-17 | Sep-17 | M | M | M |
| Interest Rates/2 | Jun-17 | Sep-17 | M | M | M |
| Consumer Price Index | Oct-17 | Nov-17 | 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-16 | Apr-17 | A | A | A |
| Stocks of Central Government and Central Government-Guaranteed Debt/5 | Jul-17 | Sep-17 | M | M | M |
| External Current Account Balance | June-17 | Sep-17 | Q | Q | Q |
| Exports and Imports of Goods and Services | Jun-17 | Sep-17 | Q | Q | Q |
| GDP/GNP (GDP production) | 2014 (Production 2014) | 2015 (Production 2014) | A | A | A |
| Gross External Debt | Jun-17 | Sep-17 | Q | Q | Q |
| International Investment Position/6 | NA | NA | NA | NA | NA |

1/ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
2/ Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
3/ Foreign, domestic bank, and domestic nonbank financing.
4/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
5/ Including currency and maturity composition.
6/ Includes external gross financial asset and liability positions vis-à-vis nonresidents.
7/ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); and not available (NA).

# MAIN WEBSITES OF DATA

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

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

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

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

INTERNATIONAL MONETARY FUND

# SOLOMON ISLANDS

January 4, 2018

## STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS[1]

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

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

*The external risk of debt distress in the Solomon Islands remains moderate, consistent with the 2016 assessment. Under the baseline scenario—adjusted for the average long-term effects of natural disasters on growth, the fiscal balance, and the current account balance— all external debt indicators remain below the relevant policy-dependent indicative thresholds. The baseline is subject to significant risks with sizable and protracted breaches of thresholds from a shock to financing terms. Adding domestic debt to the analysis does not alter the overall risk of debt distress, although the baseline rapidly approaches the indicative threshold under the public debt-to-GDP ratio towards the end of the projection period. That said, public debt is on an upward trajectory and could rise above the authorities' nominal public debt limit of 30 percent of GDP by 2028. A shock to real GDP growth would cause a significant breach of the public debt-to-GDP threshold.*

*Since Solomon Islands is highly vulnerable to natural disasters, the analysis has been complemented with a stress test of a single severe natural disaster occurring in 2018—of similar scale to the largest shock in Solomon Islands' history. Debt sustainability deteriorates in the aftermath of the event and growth declines with public debt to GDP ratio rising close to the threshold.*

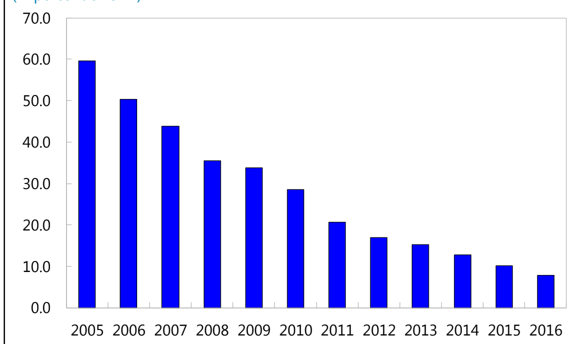
*Solomon Islands fiscal performance has deteriorated recently, adding to prospective vulnerability. Fiscal buffers have been eroded and domestic arrears are accumulating. Both revenue raising measures and expenditure control measures are required to place the fiscal position on a firmer footing and to enable Solomon Islands to respond to shocks.*

[1] The policies and institutions of Solomon Islands, as measured by the CPIA, averaged 2.96 over the past three years. Since its average CPIA index has been below 3.25 for three years in a row, the country's policy performance remains classified as weak, according to the "Staff Guidance Note on the Application of the Joint Fund-Bank Debt Sustainability Framework for Low-income Countries" (www.imf.org/external/np/pp/eng/2010/012210.pdf). Therefore, the relevant indicative thresholds for this category are: 30 percent for the PV of debt-to-GDP ratio, 100 percent for the PV of debt-to-exports ratio, 200 percent for the PV of debt-to-revenue ratio, 15 percent for the debt service-to-exports ratio, and 18 percent for the debt service-to-revenue ratio. These thresholds are applicable to public and publicly guaranteed external debt.

# BACKGROUND

1. **Good progress has been made over the past decade in building fiscal buffers and reducing public debt from 50.3 percent of GDP in 2006 to just 7.9 percent of GDP at end-2016.** In 2005, the Honiara Club Agreement restructured around 10 percent of the stock of external public debt and a moratorium was placed on debt servicing and new external borrowing. Following further improvement in the debt position, the agreement was reviewed and a new debt management framework was introduced in 2012 which enabled the resumption of concessional external borrowing. In September 2016, the debt management framework was revised and strengthened—with new guidelines on direct borrowing, on-lending, and guarantees. The debt management strategy stipulates a limit for the public debt-to-GDP ratio and debt service to domestically sourced revenue ratio set at 30 percent and 10 percent respectively. The guidelines also require the government to aim for its risk of debt distress to be no more than moderate, as defined by the Debt Sustainability Analysis (DSA).

**Gross Public Debt**
(In percent of GDP)

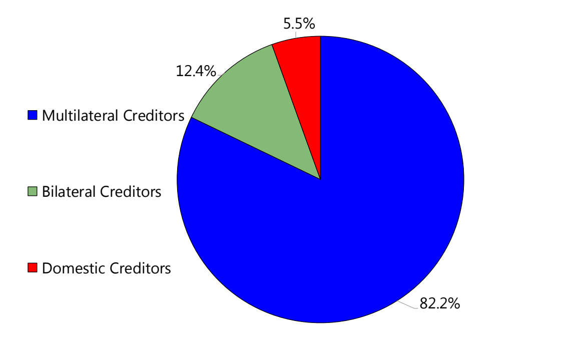



Sources: Solomon Islands authorities and IMF staff calculations

2. **External Public and Publicly Guaranteed (PPG) debt stood at US$89 million (7.5 percent of GDP) in 2016 while private sector external debt amounted to just 0.8 percent of GDP.** The private sector in the Solomon Islands has very limited capacity to borrow externally.

3. **Multilateral and bilateral official creditors account for the bulk of all loans.** The International Development Association (IDA) and the Asian Development Bank (ADB) account for 37.0 percent and 36.9 percent of total external PPG debt respectively, while the share of bilateral creditors—Taiwan Province of China and EU— is 13.1 percent of the total. Australia and New Zealand are important donors for the country, together providing over two-thirds of total Official Development Assistance to Solomon Islands.

**Breakdown of Public Debt Holders**




Sources: Solomon Islands authorities and IMF staff estimates.

**Stock of external and domestic debt at end-2016**

| | In million of US dollars | As a share of total debt | In percent of GDP |
|---|---|---|---|
| Total external debt | 98.7 | 100% | 8.2% |
| of which: Public and Publicly Guaranteed (PPG) | 89.3 | 91% | 7.5% |
| of which: Private | 9.4 | 9% | 0.8% |
| | In million of SI dollars | As a share of total debt | In percent of GDP |
| Total public debt | 774.8 | 100% | 7.9% |
| of which: external | 732.2 | 95% | 7.5% |
| of which: domestic | 42.6 | 5% | 0.4% |
| Contingent Liabilities from SOEs | 121.1 | - | 1.2% |

Source: Solomon Islands authorities and IMF staff estimates.

4. **Public domestic debt at end-2016 stood at SI$42.6 million (0.4 percent of GDP), most of which was in Treasury bills.** In December 2015, the entire stock of government bonds, amounting to SI$99.5 million, was repaid ahead of schedule. The implicit contingent liabilities from state-owned enterprises were around SI$121 million (1.2 percent of GDP) at end-2016.

5. **However, fiscal performance has deteriorated recently and borrowing is on an upward trajectory.** The government tripled its annual borrowing limit from SI$300 million in the 2016 budget to SI$900 million in the 2017 budget; SI$600 million was set aside for the Tina River hydropower project, while the remaining SI$300 million has been earmarked for other purposes, including the undersea cable project. In March 2017, the government issued domestic development bonds, worth SI$150 million, which were purchased by the country's national pension fund, the Solomon Islands National Provident Fund. This increased the level of public debt to about 9.4 percent of GDP. The government also intends to issue additional bonds amounting to SI$150 million by end-2018. Disbursements for the Tina River hydropower development projects are expected to begin in 2018 (Box 1), for which in early 2017, the government also provided guarantees, worth US$15.4 million (about SI$122 million).

### Box 1. Tina River Hydropower Development Project (TRHDP)

**Solomon Islands' first large-scale energy project, aims to reduce electricity costs—one of the highest in the world—and reduce reliance on diesel imports.** It leads efforts to diversify electricity generation in favor of clean, renewable sources such as hydro and solar power. It has the potential to cut by more than half of annual greenhouse gas emission. The project will consist of four components: (i) hydropower facility (estimated cost: US$185.6 million); (ii) access road (US$25 million); (iii) transmission line (US$22.8 million); and (iv) technical assistance (US$7.0 million).

**The project is supported by many development partners.** It will be completed over 2018–22.

**Financing Scheme**
(In millions of US dollar)

| | Total | Loan | Grant |
|---|---|---|---|
| GCF | 86.0 | 70.0 | 16.0 |
| WB/IDA | 33.6 | 24.7 | 8.9 |
| ADB | 30.0 | 18.0 | 12.0 |
| IRENA/ADFD | 15.0 | 15.0 | |
| EDCF | 31.6 | 31.6 | |
| Australia | 11.7 | | 11.7 |
| Total | 207.9 | 159.3 | 48.6 |

Source: Consideration of funding proposals - Addendum VII, Green Climate Fund.

**Disbursement Schedule (TRHDP)**
(In millions of US dollar)

| | Total | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|
| GCF | 70.0 | 28.0 | 14.0 | 14.0 | 14.0 |
| WB/IDA | 24.7 | 8.0 | 4.0 | 6.4 | 6.4 |
| ADB | 18.0 | 7.2 | 3.6 | 3.6 | 3.6 |
| IRENA/ADFD | 15.0 | 1.7 | 0.9 | 6.2 | 6.2 |
| EDCF | 31.6 | 12.6 | 6.3 | 6.3 | 6.3 |
| Total | 159.3 | 57.5 | 28.8 | 36.5 | 36.5 |

Source: Consideration of funding proposals - Addendum VII, Green Climate Fund.

# ASSUMPTIONS UNDER THE BASELINE AND CUSTOMIZED SCENARIOS

## A. The Baseline Scenario

6. **The macroeconomic assumptions in the DSA reflect developments through mid-2017 and incorporate the risk of natural disasters and climate change over the longer-term.** The baseline scenario is based on current policies and is consistent with the macroeconomic framework presented in the Staff Report. The years 2017–22 are assumed to be disaster free to simplify the policy discussion of the near-term outlook. However, from 2023 onwards, the baseline includes the average long-term effects of natural disasters and climate change by lowering GDP growth, raising imports and increasing the fiscal deficit. 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 2017–22 reflecting the net impact of three factors—(i) a push for higher infrastructure spending; offset by: (ii) continuing public financial management problems which have resulted in domestic arrears and are impeding private sector activity; and (iii) slightly declining logging production. In the long-term, growth is expected to rise to 3.2 percent during 2023–37 due to positive spillovers from infrastructure development, and an increase in mining activity which more than offsets the long-term decline of the forestry sector. This includes the average likely effect of natural disasters and climate change which lowers the growth rate by 0.3 percentage points annually (without natural disasters growth would be around 3.5 percent).

- **Inflation** (measured by GDP deflator in USD terms) is projected to average 3.2 percent during 2017–22, and 4.3 percent during 2023–37 in line with a pickup in real GDP growth to trend and is a little lower than its historical average (of 5.7 percent).

- **Non-interest current account deficit** is projected to widen to 5.6 percent of GDP on average over 2017–22 as infrastructure projects (including the TRHDP and the undersea cable project) have a high import content. The reopening of the Gold Ridge Mine and the resumption of exports is now expected to be delayed until 2023. The overall current account deficit is expected to increase to 6.1 percent of GDP on average during 2023–37, mainly reflecting an assumption that the probability of natural disasters and climate change adds 0.4 percentage points to the deficit annually.

- **FDI inflows** are expected to increase on average to about 3.6 percent of GDP over the 2017–22 based on current infrastructure spending plans and are expected to remain at around 3.4 percent of GDP over the long term, 2023–37.

- **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. The Gold Ridge Mine is not assumed to reopen quickly (and so is an upside risk to our baseline projection). Over the longer term, gold production is assumed to resume in 2023 and is assumed to peak at 62,000 ounces per annum from 2024 to 2027 and then to decrease gradually. The mine's production is assumed to run for 10 years with a cumulative output of 445,000 ounces, slightly lower than it was assumed in the previous DSA as the continued delay in rehabilitating the mine is likely to have increased the cost of repairs and reduced the economically feasible level of production. Other mining activity (nickel and bauxite) is expected to come fully onstream in the long run, but this is implicitly assumed into long-term growth rates, given the lack of complete information on productive capacity and production projections.

- **External borrowing and grants**: Disbursements for projects in the pipeline supported by the IDA and the ADB are expected to take place in the next five years (2017–21).[2] From 2022 onwards, new external borrowing is projected to average 3.1 percent of GDP, the same level as during 2017–21. Aid flows are expected to grow over the medium term due to the scale-up of IDA and ADB financing but to fall back over the longer run with the grant element of new borrowing declining to about 38

[2] For TRHDP, the disbursement schedule is taken from the Green Climate Fund paper.

percent by 2037. Revenues excluding grants fall to around 29.5 percent of GDP over the long term compared to around 31 percent of GDP in the previous DSA.

- **Fiscal outlook**: The primary deficit is expected to deteriorate from 3.2 percent of GDP in 2016 to 4.0 percent in 2017 and 5.5 percent in 2018 due to an increase in spending on the undersea cable project and TRHDP. The deficit is expected to remain high, averaging 3.7 percent of GDP during 2023–37, due to lower revenues from logging and mining and a high level of development spending. From 2023 onwards, the long-term effect of natural disasters and climate change widens the deficit by 0.2 percentage points annually. The deficit is expected to be financed by both domestic and external borrowing.

**Solomon Islands: Baseline Macroeconomic Assumptions**

(In percent of GDP, unless otherwise stated)

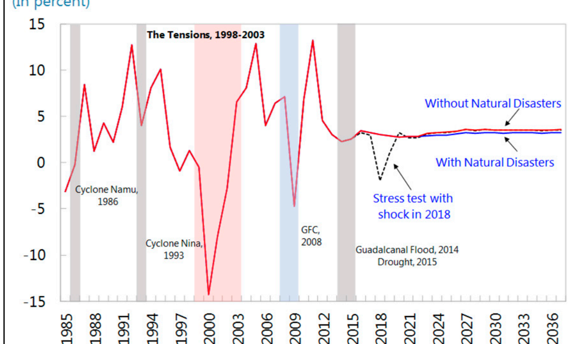
| | | | | | | | | 2017 DSA | | | 2016 DSA | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2017-22 ave. | 2023-37 ave. | Effect of ND and CC | 2016-21 ave. | 2022-36 ave. |
| Real GDP growth | 3.5 | 3.2 | 3.0 | 2.9 | 2.8 | 2.8 | 2.8 | 2.9 | 3.2 | 0.3 | 3.1 | 3.5 |
| GDP deflator in US dollar terms (change in percent) | 3.0 | 0.2 | 4.6 | 3.2 | 3.5 | 3.8 | 3.9 | 3.2 | 4.3 | | 2.3 | 4.0 |
| Non-interest current account deficit | 3.8 | 4.3 | 4.9 | 6.3 | 6.6 | 5.8 | 6.0 | 5.6 | 6.1 | 0.4 | 5.4 | 6.1 |
| Net FDI (negative = inflow ) | -2.9 | -4.6 | -2.5 | -3.6 | -3.7 | -3.8 | -3.6 | -3.6 | -3.4 | | -3.4 | -3.4 |
| Primary deficit | 3.2 | 4.0 | 5.5 | 3.6 | 3.2 | 2.9 | 2.8 | 3.7 | 3.7 | 0.2 | -0.7 | -1.4 |

Source: IMF staff projections.

## B. The Customized Scenario with A One-off Natural Disaster Shock

**Real GDP Growth Trajectory**

(In percent)




Sources: IMF staff estimates.

7. **A one-off severe natural disaster shock is assumed to occur in 2018 adding to external borrowing as well as adjusting GDP growth and the current account.** Solomon Islands, like other Pacific island countries, is highly vulnerable to natural disasters. EM-DAT, the international disaster database, shows that for the past twenty-seven years (1980-2016), the country's largest damage from natural disasters was 14 percent of GDP. The customized scenario assumes a natural disaster of this scale hits in 2018 and the same amount of funds for recovery and reconstruction is financed by a mix of grants (4.0 percent of GDP) and concessional loans (10.0 percent of GDP). GDP growth falls by around 5.0 percentage points in 2018—a similar swing to that seen in previous large disaster years (excluding events during the tensions and the global financial crisis) and is expected to rise by 3.0 percentage points in 2019 and

**Solomon Islands: Macroeconomic Assumptions Under the Customized Scenario**

(In percent of GDP, unless otherwise stated)

| Deviation from the baseline | 2018 | 2019 | 2020 |
|---|---|---|---|
| GDP growth (percentage points) | -5.0% | 3.0% | 2.2% |
| Current account balance | -3.0% | -4.0% | -4.0% |
| Financing | 14.0% | | |
| Grants | 4.0% | | |
| Concessional Loans | 10.0% | | |

Source: IMF staff projections.

2.2 percentage points in 2020, with the level of GDP returning to the baseline in 2020. The current account deficit is assumed to be higher over 2018–20 due to damage to the export base and increases in imports for reconstruction. From 2023 onwards the shock scenario includes the average long-term effect of natural disasters.

**8. The scenario highlights that while the debt level is currently low, Solomon Islands is highly susceptible to shocks and a sizeable buffer is needed to cope with unexpected events.** The recent deterioration of the fiscal position and rundown of the cash balance leave the authorities ill-equipped to handle even a small shock.

# DEBT SUSTAINABILITY

## A. External Debt Sustainability Analysis

**9. Under the baseline scenario, all PV of external PPG debt indicators remain below the policy relevant thresholds (Figure 1).** Total external PPG debt is projected to gradually increase from 7.5 percent of GDP in 2016 to 18.2 percent in 2021 due mainly to new disbursements from the TRHDP project and continue to grow to 30.1 percent of GDP in 2037 (Table 1).

**10. However, the sensitivity analysis shows that the debt dynamics deteriorate under alternative scenarios with less favorable terms on new borrowing having the largest impact.** A shock to financing terms— a rise in interest rates on new borrowing by 2 percentage points compared to the baseline—remains the most important risk to sustainability, causing the breach of the indicative threshold of the PV of debt-to-GDP ratio and the PV of debt-to-export ratio (Figure 1). This suggests that external borrowing should be contracted on concessional terms as much as possible to contain the debt burden.

**11. The severe natural disaster shock causes all the debt trajectories for each external debt indicator to move upward, indicating that debt sustainability has deteriorated after the shock.** Given the current low level of external debt, the indicators remain below thresholds. However, while two severe shocks are unlikely to hit within a twenty-year horizon, the country could be hit by two bigger than average shocks—as the probability of a disaster causing more than 3 percent of GDP in damage and affecting more than 5 percent of the population is likely to occurs every seven years—and this could have a larger cumulative effect on debt sustainability, especially if it results in a prolonged period of low growth.

## B. Public Sector Debt Sustainability Analysis

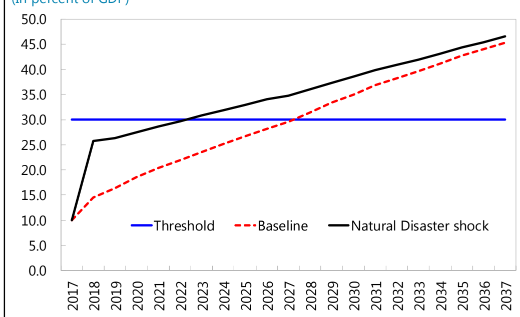
**12. The PV of public sector debt in percent of GDP remains below the threshold under the baseline scenario (Figure 2).** However, the public debt-to-GDP ratio continues to rise from 7.9 percent and on current policies breaches the authorities' threshold of 30 percent in 2028 (Table 4). The breach is primarily driven by a high disbursement schedule and continued expansionary fiscal policy.

**13. Sensitivity analysis also reveals that public debt sustainability remains vulnerable to shocks, particularly to the severe shock to real GDP growth (Figure 2).** The PV of debt-to-GDP ratio breaches the 38 percent of GDP benchmark by 2026, highlighting the need for stronger growth in the long run.

**14. The severe natural disaster shock results in a sharper deterioration in debt sustainability.** The public debt-to-GDP ratio would breach the authorities' threshold of 30 percent in 2023, five years earlier than in the baseline scenario.

**15. The breach of the public debt threshold set by the authorities under the baseline and natural disaster scenarios highlights the importance of fiscal consolidation over the medium term.** As shown in Figure 2 in the Annex for the fixed primary balance scenario, which assumes an unchanged primary balance from 2016 for the entire projection period, the PV of the debt-to-GDP ratio, the PV of the debt-to-revenue ratio, and debt service-to-revenue ratio would be higher than the baseline over the projection period.

**Public Debt-to-GDP ratio**
(In percent of GDP)



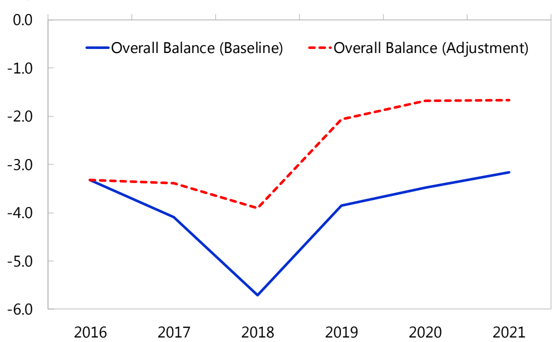

Sources: IMF staff estimates.

## C. Policy Adjustment Scenario

**16. As highlighted in the staff report, fiscal policy needs to be placed on a firmer footing, first by rebuilding the cash balance**. The policy adjustment scenario demonstrates how this can be achieved. While debt levels are similar in the early years, as cash buffers are rebuilt, debt levels are lower over the longer-term (see Figure 3 which illustrated the policy adjustment scenario).

**Fiscal Deficit: Baseline and Alternative Scenario**

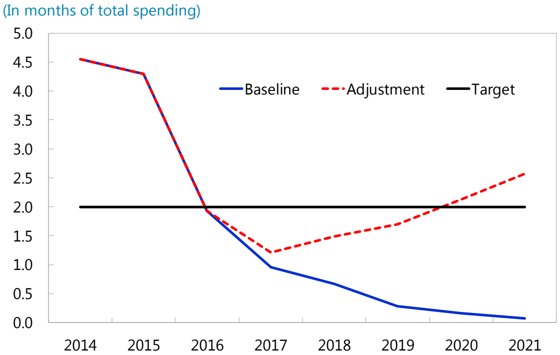
**Overall Balance**
(In percent of GDP)




Sources: IMF staff estimates.

**Cash Balance**

**Broader Cash Balance**
(In months of total spending)




Sources: IMF staff estimates.

# CONCLUSION

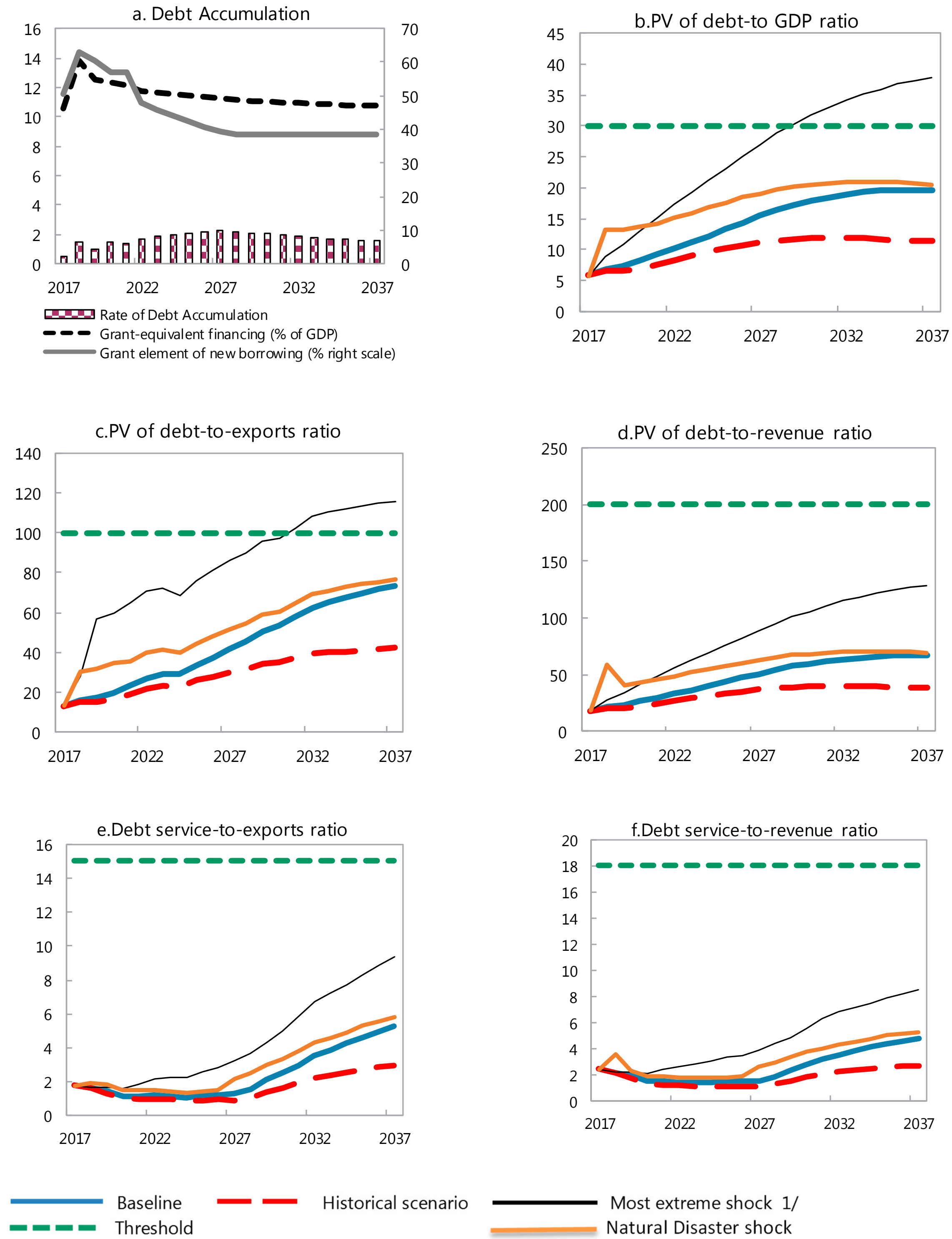
**17. The current DSA suggests that Solomon Islands' risk of external debt distress continues to be moderate.** The baseline scenario takes into account the long-term effects of natural disasters and climate change by adjusting real GDP growth, the current account balance, and fiscal balance from 2023 onwards. While there is no breach of thresholds under the baseline, the stress test with a shock to financing terms on new borrowing indicates that the PV of external debt-to-GDP ratio and the PV of external debt-to-exports ratio breach the respective policy-dependent indicative debt thresholds for some years. Overall the analysis illustrates the vulnerability of debt sustainability to external financing, fiscal and growth shocks and the important contribution of aid flows and FDI to supporting debt sustainability. This highlights the importance of being cautious on expenditures, prioritizing investment projects that build resilience to natural disasters and other investments that can help boost potential growth and broaden the export base or reduce reliance on imports. To keep the debt burden contained, external borrowing should be contracted on concessional terms as much as possible.

**18. Public debt is on a rising trajectory and under current policies could breach the threshold set by the authorities at 30 percent of GDP in 2028, indicating the need to tighten fiscal policy, strengthen public financial management, and boost the long-term economic growth.** A shock to real GDP growth has the largest impact on public debt sustainability, leading the PV of debt-to-GDP ratio to breach the 38 percent of GDP benchmark by 2030. The customized scenario, with a one-off severe natural disaster shock, also shows that debt sustainability can quickly deteriorate in response to a shock. Given the vulnerability to natural disaster shocks, the authorities need to recalibrate fiscal policy first to rebuild a fiscal buffer to enable smoother month-to-month cash management and this is likely to require both stronger revenue mobilization efforts and expenditure rationalization.

# AUTHORITIES' VIEW

**19. The authorities broadly agree with the assessment of debt sustainability analysis and welcome the incorporation of the average long-term effects of natural disasters and climate change into the baseline.** In the medium term, they intend to increase both external borrowing, mainly for the Tina River hydropower project, and domestic borrowing for large infrastructure projects, especially for the undersea cable project. The authorities noted that they are mindful of the burden of external debt, and given their vulnerability to changes in financing terms, they would like to seek external concessional and preferably grant finance for the bulk of external assistance. The authorities noted the uncertainty over the quality of nominal GDP data and the different estimates of the Ministry of Finance and IMF staff. They noted the IMF staff's response that the differences in nominal GDP estimates were not large enough to impact on the risk rating. They highlighted that the National Statistics Office is working on revising and strengthening the GDP data and that the new data will be published early next year.

**Figure 1. Solomon Islands: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2017–37 1/**




Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2027. In figure b. it corresponds to a Terms shock; in c. to a Exports shock; in d. to a Terms shock; in e. to a Terms shock and in figure f. to a Terms shock

## Table 1. Solomon Islands: External Debt Sustainability Framework, Baseline Scenario, 2014–37 1/

(In percent of GDP, unless otherwise indicated)

| | Actual | | | Historical 6/ Average | Standard 6/ Deviation | Projections | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | | | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2017-2022 Average | 2023 | 2024 | 2025 | 2026 | 2027 | 2037 | 2023-2037 Average |
| **External debt (nominal) 1/** | **12.0** | **10.6** | **8.2** | | | **9.0** | **12.8** | **14.9** | **17.3** | **19.3** | **21.1** | | **22.6** | **24.1** | **25.5** | **26.9** | **28.0** | **32.1** | |
| *of which: public and publicly guaranteed (PPG)* | 9.9 | 9.7 | 7.5 | | | 8.2 | 11.9 | 13.9 | 16.2 | 18.2 | 19.9 | | 21.3 | 22.8 | 24.1 | 25.4 | 26.5 | 30.3 | |
| Change in external debt | -7.2 | -1.4 | -2.4 | | | 0.8 | 3.8 | 2.1 | 2.4 | 2.0 | 1.8 | | 1.5 | 1.5 | 1.4 | 1.4 | 1.1 | -0.1 | |
| Identified net debt-creating flows | 1.8 | 0.8 | 0.4 | | | -0.4 | 2.3 | 2.4 | 2.6 | 1.7 | 2.1 | | 1.9 | 2.0 | 2.2 | 2.4 | 2.4 | 1.9 | |
| **Non-interest current account deficit** | **3.8** | **2.8** | **3.8** | 10.4 | 10.7 | **4.3** | **4.9** | **6.3** | **6.6** | **5.8** | **6.0** | 5.6 | **5.7** | **5.9** | **6.0** | **6.2** | **6.4** | **5.8** | 6.1 |
| Deficit in balance of goods and services | 9.9 | 8.1 | 5.8 | | | 6.6 | 8.3 | 10.1 | 10.5 | 11.7 | 12.4 | | 12.2 | 11.3 | 11.9 | 12.5 | 13.1 | 12.5 | |
| Exports | 48.3 | 45.5 | 44.9 | | | 44.2 | 42.8 | 42.4 | 41.7 | 39.8 | 38.1 | | 38.5 | 42.2 | 39.5 | 38.5 | 37.2 | 26.8 | |
| Imports | 58.2 | 53.5 | 50.7 | | | 50.8 | 51.2 | 52.5 | 52.2 | 51.5 | 50.4 | | 50.6 | 53.4 | 51.5 | 51.0 | 50.3 | 39.4 | |
| Net current transfers (negative = inflow) | -8.7 | -7.1 | -5.2 | -14.4 | 6.7 | -5.9 | -6.7 | -7.0 | -7.2 | -7.7 | -8.0 | -7.1 | -8.5 | -8.7 | -8.8 | -9.0 | -9.1 | -6.9 | -8.9 |
| *of which: official* | -8.5 | -8.1 | -7.1 | | | -7.5 | -8.2 | -8.0 | -7.9 | -8.1 | -8.1 | | -8.3 | -8.2 | -8.2 | -8.2 | -8.1 | -5.1 | |
| Other current account flows (negative = net inflow) | 2.5 | 1.9 | 3.2 | | | 3.5 | 3.3 | 3.1 | 3.3 | 1.8 | 1.6 | | 2.0 | 3.3 | 3.0 | 2.7 | 2.5 | 0.1 | |
| **Net FDI (negative = inflow)** | **-1.7** | **-2.4** | **-2.9** | -8.4 | 7.3 | **-4.6** | **-2.5** | **-3.6** | **-3.7** | **-3.8** | **-3.6** | -3.6 | **-3.5** | **-3.5** | **-3.5** | **-3.4** | **-3.5** | **-3.4** | -3.4 |
| **Endogenous debt dynamics 2/** | **-0.2** | **0.4** | **-0.5** | | | **-0.1** | **-0.1** | **-0.2** | **-0.2** | **-0.3** | **-0.3** | | **-0.3** | **-0.4** | **-0.4** | **-0.4** | **-0.5** | **-0.5** | |
| Contribution from nominal interest rate | 0.5 | 0.2 | 0.1 | | | 0.1 | 0.1 | 0.2 | 0.2 | 0.2 | 0.2 | | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 | 0.5 | |
| Contribution from real GDP growth | -0.4 | -0.3 | -0.3 | | | -0.3 | -0.3 | -0.4 | -0.4 | -0.5 | -0.5 | | -0.6 | -0.6 | -0.7 | -0.7 | -0.8 | -1.0 | |
| Contribution from price and exchange rate changes | -0.3 | 0.5 | -0.3 | | | ... | ... | ... | ... | ... | ... | | ... | ... | ... | ... | ... | ... | |
| **Residual (3-4) 3/** | **-9.0** | **-2.3** | **-2.7** | | | **1.2** | **1.5** | **-0.4** | **-0.2** | **0.3** | **-0.3** | | **-0.4** | **-0.5** | **-0.8** | **-1.0** | **-1.3** | **-2.0** | |
| *of which: exceptional financing* | 0.0 | 0.0 | 0.0 | | | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| PV of external debt 4/ | ... | ... | 6.6 | | | 6.7 | 7.7 | 8.4 | 9.4 | 10.3 | 11.4 | | 12.5 | 13.6 | 14.7 | 15.9 | 17.0 | 21.6 | |
| In percent of exports | ... | ... | 14.6 | | | 15.1 | 18.1 | 19.8 | 22.5 | 25.9 | 29.9 | | 32.4 | 32.3 | 37.3 | 41.3 | 45.6 | 80.3 | |
| **PV of PPG external debt** | **...** | **...** | **5.8** | | | **5.8** | **6.8** | **7.4** | **8.3** | **9.2** | **10.2** | | **11.2** | **12.2** | **13.3** | **14.4** | **15.5** | **19.7** | |
| **In percent of exports** | **...** | **...** | **12.9** | | | **13.1** | **15.9** | **17.5** | **20.0** | **23.0** | **26.7** | | **29.1** | **29.1** | **33.7** | **37.4** | **41.5** | **73.3** | |
| **In percent of government revenues** | **...** | **...** | **18.3** | | | **18.3** | **21.6** | **23.6** | **26.7** | **29.5** | **32.9** | | **36.5** | **39.9** | **43.4** | **47.2** | **50.8** | **66.8** | |
| **Debt service-to-exports ratio (in percent)** | **16.5** | **4.9** | **3.6** | | | **2.0** | **1.8** | **1.6** | **1.3** | **1.3** | **1.3** | | **1.3** | **1.2** | **1.3** | **1.4** | **1.4** | **5.6** | |
| **PPG debt service-to-exports ratio (in percent)** | **1.6** | **1.5** | **1.8** | | | **1.8** | **1.6** | **1.4** | **1.1** | **1.2** | **1.2** | | **1.2** | **1.1** | **1.2** | **1.2** | **1.3** | **5.3** | |
| **PPG debt service-to-revenue ratio (in percent)** | **2.3** | **2.0** | **2.6** | | | **2.5** | **2.2** | **1.9** | **1.5** | **1.5** | **1.5** | | **1.5** | **1.5** | **1.5** | **1.6** | **1.5** | **4.8** | |
| Total gross financing need (Millions of U.S. dollars) | 117.4 | 31.0 | 30.9 | | | 6.8 | 43.3 | 48.6 | 52.9 | 40.7 | 51.8 | | 52.0 | 59.7 | 67.8 | 78.8 | 87.4 | 203.9 | |
| Non-interest current account deficit that stabilizes debt ratio | 10.9 | 4.3 | 6.2 | | | 3.5 | 1.1 | 4.2 | 4.2 | 3.7 | 4.2 | | 4.1 | 4.3 | 4.6 | 4.8 | 5.2 | 5.8 | |
| **Key macroeconomic assumptions** | | | | | | | | | | | | | | | | | | | |
| Real GDP growth (in percent) | 2.3 | 2.5 | 3.5 | 4.5 | 4.6 | 3.2 | 3.0 | 2.9 | 2.8 | 2.8 | 2.8 | 2.9 | 2.9 | 3.0 | 3.0 | 3.1 | 3.3 | 3.3 | 3.2 |
| GDP deflator in US dollar terms (change in percent) | 1.6 | -3.8 | 3.0 | 5.7 | 6.7 | 0.2 | 4.6 | 3.2 | 3.5 | 3.8 | 3.9 | 3.2 | 4.5 | 4.1 | 4.3 | 4.0 | 4.5 | 4.5 | 4.3 |
| Effective interest rate (percent) 5/ | 2.7 | 1.6 | 1.3 | 2.4 | 0.6 | 1.7 | 1.8 | 1.4 | 1.3 | 1.2 | 1.2 | 1.4 | 1.2 | 1.3 | 1.3 | 1.3 | 1.4 | 1.7 | 1.5 |
| Growth of exports of G&S (US dollar terms, in percent) | -1.1 | -7.1 | 5.4 | 15.2 | 25.8 | 1.7 | 4.4 | 5.2 | 4.7 | 1.7 | 2.2 | 3.3 | 8.6 | 17.4 | 0.7 | 4.4 | 4.4 | 5.6 | 5.1 |
| Growth of imports of G&S (US dollar terms, in percent) | -4.0 | -9.3 | 1.0 | 10.8 | 21.8 | 3.6 | 8.6 | 9.0 | 5.7 | 5.2 | 4.7 | 6.1 | 7.9 | 13.1 | 3.5 | 6.3 | 6.4 | 6.8 | 5.8 |
| Grant element of new public sector borrowing (in percent) | ... | ... | ... | ... | ... | 50.7 | 62.8 | 60.5 | 56.9 | 56.9 | 48.0 | 56.0 | 46.0 | 44.1 | 42.3 | 40.8 | 39.5 | 38.4 | 39.8 |
| Government revenues (excluding grants, in percent of GDP) | 32.8 | 35.1 | 31.7 | | | 31.7 | 31.5 | 31.4 | 31.2 | 31.0 | 30.9 | | 30.7 | 30.7 | 30.7 | 30.6 | 30.4 | 29.5 | |
| Aid flows (in Millions of US dollars) 7/ | 170.4 | 149.0 | 117.2 | | | 147.3 | 212.8 | 200.5 | 209.3 | 218.6 | 219.5 | | 232.2 | 245.0 | 259.5 | 274.6 | 292.6 | 582.5 | |
| *of which: Grants* | 170.4 | 149.0 | 117.2 | | | 121.7 | 148.9 | 154.4 | 160.9 | 170.7 | 181.5 | | 194.1 | 207.0 | 221.2 | 236.0 | 253.3 | 504.7 | |
| *of which: Concessional loans* | 0.0 | 0.0 | 0.0 | | | 25.7 | 63.9 | 46.1 | 48.4 | 47.9 | 38.1 | | 38.0 | 38.0 | 38.3 | 38.6 | 39.3 | 77.8 | |
| Grant-equivalent financing (in percent of GDP) 8/ | ... | ... | ... | | | 10.5 | 13.8 | 12.5 | 12.3 | 12.1 | 11.7 | 12.2 | 11.6 | 11.5 | 11.4 | 11.3 | 11.2 | 10.7 | 11.1 |
| Grant-equivalent financing (in percent of external financing) 8/ | ... | ... | ... | | | 91.4 | 88.6 | 90.8 | 89.1 | 89.6 | 87.8 | 89.6 | 87.3 | 86.8 | 86.3 | 85.9 | 85.5 | 84.8 | 85.4 |
| *Memorandum items:* | | | | | | | | | | | | | | | | | | | |
| Nominal GDP (Millions of US dollars) | 1174.0 | 1158.4 | 1235.0 | | | 1277.0 | 1376.8 | 1462.8 | 1555.6 | 1659.3 | 1772.5 | | 1905.9 | 2041.9 | 2193.4 | 2351.8 | 2537.1 | 5288.6 | |
| Nominal dollar GDP growth | 3.9 | -1.3 | 6.6 | | | 3.4 | 7.8 | 6.2 | 6.3 | 6.7 | 6.8 | 6.2 | 7.5 | 7.1 | 7.4 | 7.2 | 7.9 | 7.9 | 7.6 |
| PV of PPG external debt (in Millions of US dollars) | | | 69.2 | | | 75.4 | 93.9 | 108.3 | 129.8 | 151.9 | 180.4 | | 213.0 | 250.1 | 292.0 | 339.1 | 392.2 | 1040.4 | |
| (PVt-PVt-1)/GDPt-1 (in percent) | | | | | | 0.5 | 1.4 | 1.0 | 1.5 | 1.4 | 1.7 | 1.3 | 1.8 | 1.9 | 2.1 | 2.1 | 2.3 | 1.5 | 1.9 |
| Gross workers' remittances (Millions of US dollars) | 0.0 | 0.0 | 0.0 | | | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| PV of PPG external debt (in percent of GDP + remittances) | ... | ... | 5.8 | | | 5.8 | 6.8 | 7.4 | 8.3 | 9.2 | 10.2 | | 11.2 | 12.2 | 13.3 | 14.4 | 15.5 | 19.7 | |
| PV of PPG external debt (in percent of exports + remittances) | ... | ... | 12.9 | | | 13.1 | 15.9 | 17.5 | 20.0 | 23.0 | 26.7 | | 29.1 | 29.1 | 33.7 | 37.4 | 41.5 | 73.3 | |
| Debt service of PPG external debt (in percent of exports + remittances) | ... | ... | 1.8 | | | 1.8 | 1.6 | 1.4 | 1.1 | 1.2 | 1.2 | | 1.2 | 1.1 | 1.2 | 1.2 | 1.3 | 5.3 | |

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

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

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes. The residuals in 2014 was due largely to net FDI, which was revised down as a result of a changes to ensure the correct treatment of net losses under reinvested earnings, in line with BPM6.

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

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

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

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

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

## Table 2. Solomon Islands: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt 2017–37

(In percent)

| | Projections | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | **2027** | 2037 |
| **PV of debt-to GDP ratio** | | | | | | | | |
| **Baseline** | 6 | 7 | 7 | 8 | 9 | 10 | **15** | 20 |
| **A. Alternative Scenarios** | | | | | | | | |
| A1. Key variables at their historical averages in 2017-2037 1/ | 6 | 7 | 7 | 7 | 8 | 8 | 11 | 11 |
| A2. New public sector loans on less favorable terms in 2017-2037 2 | 6 | 9 | 11 | 13 | 15 | 17 | **27** | 38 |
| **B. Bound Tests** | | | | | | | | |
| B1. Real GDP growth at historical average minus one standard deviation in 2018-2019 | 6 | 7 | 8 | 9 | 10 | 11 | **16** | 21 |
| B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/ | 6 | 10 | 17 | 18 | 19 | 19 | **23** | 22 |
| B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019 | 6 | 7 | 8 | 9 | 10 | 11 | **17** | 22 |
| B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/ | 6 | 7 | 9 | 10 | 10 | 11 | **17** | 20 |
| B5. Combination of B1-B4 using one-half standard deviation shocks | 6 | 4 | 3 | 4 | 5 | 7 | **13** | 19 |
| B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/ | 6 | 10 | 10 | 12 | 13 | 14 | **22** | 28 |
| **PV of debt-to-exports ratio** | | | | | | | | |
| **Baseline** | 13 | 16 | 17 | 20 | 23 | 27 | **42** | 73 |
| **A. Alternative Scenarios** | | | | | | | | |
| A1. Key variables at their historical averages in 2017-2037 1/ | 13 | 15 | 15 | 16 | 19 | 22 | 30 | 43 |
| A2. New public sector loans on less favorable terms in 2017-2037 2 | 13 | 21 | 25 | 31 | 38 | 45 | **72** | 141 |
| **B. Bound Tests** | | | | | | | | |
| B1. Real GDP growth at historical average minus one standard deviation in 2018-2019 | 13 | 16 | 17 | 20 | 23 | 27 | **42** | 73 |
| B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/ | 13 | 28 | 57 | 60 | 65 | 70 | **86** | 115 |
| B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019 | 13 | 16 | 17 | 20 | 23 | 27 | **42** | 73 |
| B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/ | 13 | 17 | 21 | 23 | 26 | 30 | **44** | 75 |
| B5. Combination of B1-B4 using one-half standard deviation shocks | 13 | 9 | 8 | 11 | 14 | 17 | **35** | 73 |
| B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/ | 13 | 16 | 17 | 20 | 23 | 27 | **42** | 73 |
| **PV of debt-to-revenue ratio** | | | | | | | | |
| **Baseline** | 18 | 22 | 24 | 27 | 30 | 33 | **51** | 67 |
| **A. Alternative Scenarios** | | | | | | | | |
| A1. Key variables at their historical averages in 2017-2037 1/ | 18 | 21 | 21 | 22 | 24 | 27 | 37 | 39 |
| A2. New public sector loans on less favorable terms in 2017-2037 2 | 18 | 28 | 34 | 42 | 49 | 56 | **89** | 129 |
| **B. Bound Tests** | | | | | | | | |
| B1. Real GDP growth at historical average minus one standard deviation in 2018-2019 | 18 | 22 | 25 | 28 | 31 | 35 | **54** | 71 |
| B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/ | 18 | 33 | 55 | 58 | 60 | 63 | **76** | 76 |
| B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019 | 18 | 23 | 26 | 29 | 33 | 36 | **56** | 74 |
| B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/ | 18 | 23 | 28 | 31 | 34 | 37 | **54** | 68 |
| B5. Combination of B1-B4 using one-half standard deviation shocks | 18 | 13 | 11 | 14 | 18 | 21 | **42** | 66 |
| B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/ | 18 | 30 | 33 | 37 | 41 | 46 | **71** | 94 |

## Table 3. Solomon Islands: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2017–37 (continued)

(in percent)

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | **Debt service-to-exports ratio** | | | | |
| **Baseline** | 2 | 2 | 1 | 1 | 1 | 1 | **1** | 5 |
| **A. Alternative Scenarios** | | | | | | | | |
| A1. Key variables at their historical averages in 2017-2037 1/ | 2 | 2 | 1 | 1 | 1 | 1 | **1** | 3 |
| A2. New public sector loans on less favorable terms in 2017-2037 2 | 2 | 2 | 2 | 2 | 2 | 2 | **3** | 9 |
| **B. Bound Tests** | | | | | | | | |
| B1. Real GDP growth at historical average minus one standard deviation in 2018-2019 | 2 | 2 | 1 | 1 | 1 | 1 | **1** | 5 |
| B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/ | 2 | 2 | 2 | 2 | 2 | 2 | **3** | 9 |
| B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019 | 2 | 2 | 1 | 1 | 1 | 1 | **1** | 5 |
| B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/ | 2 | 2 | 1 | 1 | 1 | 1 | **1** | 5 |
| B5. Combination of B1-B4 using one-half standard deviation shocks | 2 | 2 | 1 | 1 | 1 | 1 | **1** | 5 |
| B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/ | 2 | 2 | 1 | 1 | 1 | 1 | **1** | 5 |
| | | | | **Debt service-to-revenue ratio** | | | | |
| **Baseline** | 2 | 2 | 2 | 2 | 2 | 1 | **2** | 5 |
| **A. Alternative Scenarios** | | | | | | | | |
| A1. Key variables at their historical averages in 2017-2037 1/ | 2 | 2 | 2 | 1 | 1 | 1 | **1** | 3 |
| A2. New public sector loans on less favorable terms in 2017-2037 2 | 2 | 2 | 2 | 2 | 2 | 3 | **4** | 9 |
| **B. Bound Tests** | | | | | | | | |
| B1. Real GDP growth at historical average minus one standard deviation in 2018-2019 | 2 | 2 | 2 | 2 | 2 | 2 | **2** | 5 |
| B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/ | 2 | 2 | 2 | 2 | 2 | 2 | **3** | 6 |
| B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019 | 2 | 2 | 2 | 2 | 2 | 2 | **2** | 5 |
| B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/ | 2 | 2 | 2 | 2 | 2 | 2 | **2** | 5 |
| B5. Combination of B1-B4 using one-half standard deviation shocks | 2 | 2 | 2 | 1 | 1 | 1 | **1** | 5 |
| B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/ | 2 | 3 | 3 | 2 | 2 | 2 | **2** | 7 |
| *Memorandum item:* | | | | | | | | |
| Grant element assumed on residual financing (i.e., financing required above baseline) 6/ | 43 | 43 | 43 | 43 | 43 | 43 | **43** | 43 |

Sources: Country authorities; and staff estimates and projections.

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

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

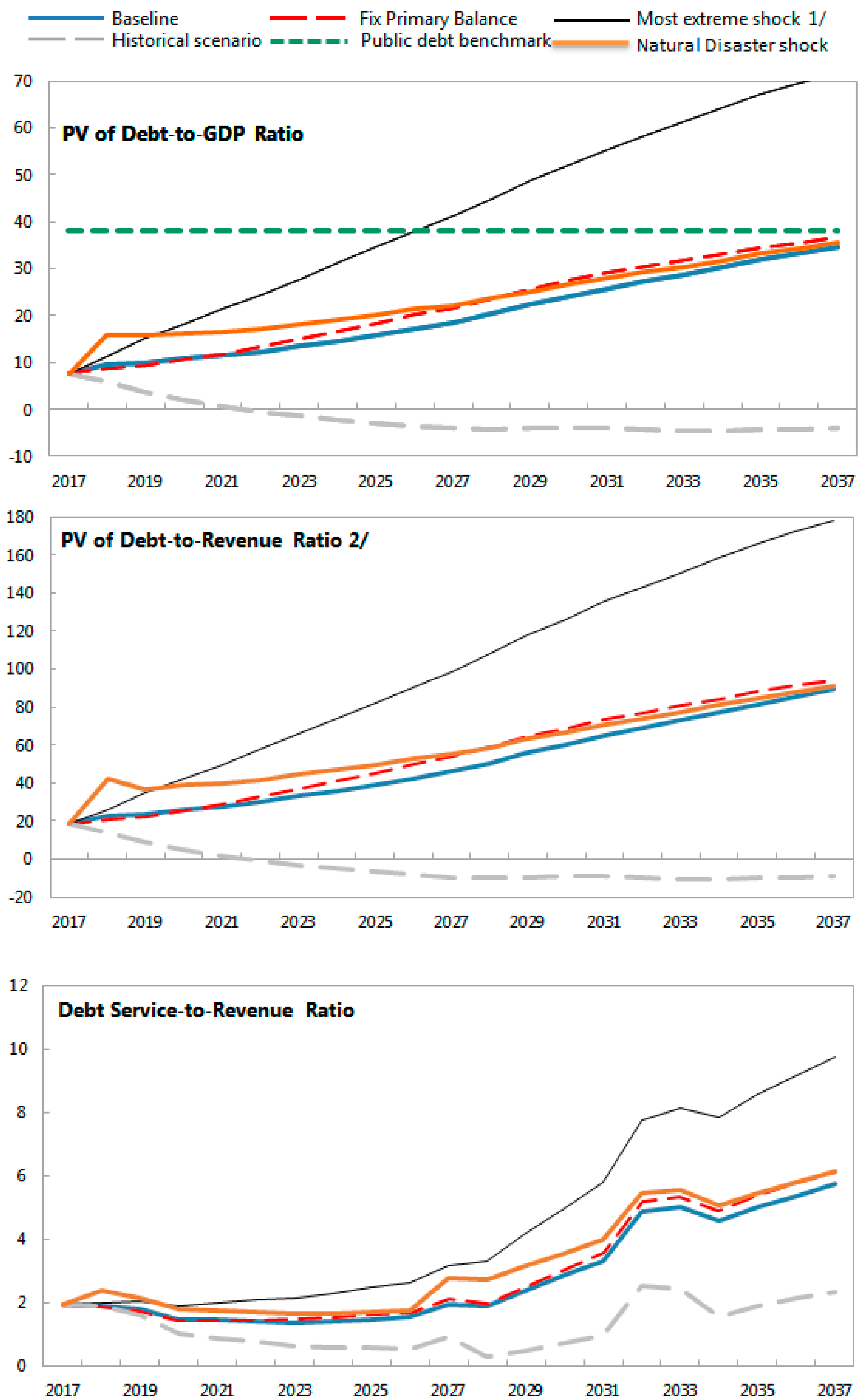
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

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

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

**Figure 2. Solomon Islands; Indicators of Public Debt Under Alternative Scenarios, 2017–37 1/**




Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2027.
2/ Revenues are defined inclusive of grants.

## Table 4. Solomon Islands; Public Sector Debt Sustainability Framework, baseline Scenario, 2014–37

(In percent of GDP, unless otherwise indicated)

| | Actual | | | | | Estimate | | | Projections | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | Average 5/ | Standard Deviation 5/ | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2017-22 Average | 2027 | 2037 | 2023-37 Average |
| **Public sector debt 1/** | 12.8 | 10.1 | 7.9 | | | 10.0 | 14.6 | 16.4 | 18.6 | 20.4 | 21.9 | | 29.6 | 45.3 | |
| *of which: foreign-currency denominated* | 9.9 | 9.7 | 7.5 | | | 8.2 | 11.9 | 13.9 | 16.2 | 18.2 | 19.9 | | 26.5 | 30.3 | |
| Change in public sector debt | -2.5 | -2.6 | -2.2 | | | 2.1 | 4.5 | 1.9 | 2.2 | 1.8 | 1.5 | | 1.4 | 1.3 | |
| Identified debt-creating flows | -2.4 | 0.4 | 2.8 | | | 3.5 | 5.2 | 3.0 | 2.5 | 2.0 | 1.7 | | 1.7 | 2.3 | |
| Primary deficit | -1.8 | 0.1 | 3.2 | -2.8 | 3.4 | 4.0 | 5.5 | 3.6 | 3.2 | 2.9 | 2.8 | 3.7 | 3.3 | 4.3 | 3.7 |
| Revenue and grants | 47.3 | 47.9 | 41.2 | | | 41.2 | 42.4 | 42.0 | 41.6 | 41.3 | 41.1 | | 40.4 | 39.0 | |
| *of which: grants* | 14.5 | 12.9 | 9.5 | | | 9.5 | 10.8 | 10.6 | 10.3 | 10.3 | 10.2 | | 10.0 | 9.5 | |
| Primary (noninterest) expenditure | 45.5 | 48.0 | 44.4 | | | 45.2 | 47.9 | 45.6 | 44.8 | 44.2 | 43.9 | | 43.7 | 43.3 | |
| Automatic debt dynamics | -0.5 | 0.3 | -0.4 | | | -0.5 | -0.4 | -0.6 | -0.7 | -0.9 | -1.0 | | -1.6 | -2.0 | |
| Contribution from interest rate/growth differential | -0.4 | -0.4 | -0.4 | | | -0.3 | -0.3 | -0.4 | -0.5 | -0.6 | -0.6 | | -0.9 | -1.2 | |
| *of which: contribution from average real interest rate* | -0.1 | -0.1 | -0.1 | | | 0.0 | 0.0 | 0.0 | 0.0 | -0.1 | -0.1 | | -0.1 | 0.2 | |
| *of which: contribution from real GDP growth* | -0.3 | -0.3 | -0.3 | | | -0.2 | -0.3 | -0.4 | -0.4 | -0.5 | -0.6 | | -0.9 | -1.4 | |
| Contribution from real exchange rate depreciation | -0.1 | 0.8 | 0.0 | | | -0.3 | -0.1 | -0.2 | -0.2 | -0.3 | -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 | |
| 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 implicit or contingent liabilities | 0.0 | 0.0 | 0.0 | | | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | 0.0 | 0.0 | |
| Debt relief (HIPC and other) | 0.0 | 0.0 | 0.0 | | | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | 0.0 | 0.0 | |
| Other (specify, e.g. bank recapitalization) | 0.0 | 0.0 | 0.0 | | | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | | 0.0 | 0.0 | |
| Residual, including asset changes 6/ | -0.1 | -3.1 | -5.0 | | | -1.4 | -0.6 | -1.1 | -0.3 | -0.2 | -0.2 | | -0.3 | -1.0 | |
| **Other Sustainability Indicators** | | | | | | | | | | | | | | | |
| **PV of public sector debt** | ... | ... | 6.2 | | | 7.6 | 9.5 | 9.9 | 10.7 | 11.4 | 12.2 | | 18.6 | 34.7 | |
| *of which: foreign-currency denominated* | ... | ... | 5.8 | | | 5.8 | 6.8 | 7.4 | 8.3 | 9.2 | 10.2 | | 15.5 | 19.7 | |
| *of which: external* | ... | ... | 5.8 | | | 5.8 | 6.8 | 7.4 | 8.3 | 9.2 | 10.2 | | 15.5 | 19.7 | |
| PV of contingent liabilities (not included in public sector debt) | ... | ... | ... | | | ... | ... | ... | ... | ... | ... | | ... | ... | |
| Gross financing need 2/ | -0.2 | 2.7 | 4.5 | | | 5.2 | 6.7 | 4.7 | 4.2 | 3.8 | 3.6 | | 4.3 | 6.6 | |
| PV of public sector debt-to-revenue and grants ratio (in percent) | ... | ... | 15.1 | | | 18.6 | 22.4 | 23.6 | 25.7 | 27.5 | 29.8 | | 45.9 | 89.1 | |
| PV of public sector debt-to-revenue ratio (in percent) | ... | ... | 19.6 | | | 24.2 | 30.1 | 31.5 | 34.3 | 36.7 | 39.6 | | 61.0 | 117.9 | |
| *of which: external 3/* | ... | ... | 18.3 | | | 18.3 | 21.6 | 23.6 | 26.7 | 29.5 | 32.9 | | 50.8 | 66.8 | |
| Debt service-to-revenue and grants ratio (in percent) 4/ | 2.5 | 4.5 | 2.0 | | | 1.9 | 1.9 | 1.8 | 1.5 | 1.4 | 1.4 | | 1.9 | 5.7 | |
| Debt service-to-revenue ratio (in percent) 4/ | 3.5 | 6.2 | 2.6 | | | 2.5 | 2.5 | 2.4 | 2.0 | 1.9 | 1.9 | | 2.6 | 7.6 | |
| Primary deficit that stabilizes the debt-to-GDP ratio | 0.7 | 2.7 | 5.5 | | | 1.9 | 1.0 | 1.7 | 1.0 | 1.1 | 1.2 | | 2.0 | 3.0 | |
| **Key macroeconomic and fiscal assumptions** | | | | | | | | | | | | | | | |
| Real GDP growth (in percent) | 2.3 | 2.5 | 3.5 | 4.5 | 4.6 | 3.2 | 3.0 | 2.9 | 2.8 | 2.8 | 2.8 | 2.9 | 3.3 | 3.3 | 3.2 |
| Average nominal interest rate on forex debt (in percent) | 1.1 | 0.9 | 1.0 | 1.3 | 0.6 | 1.4 | 1.4 | 1.1 | 1.0 | 0.9 | 0.9 | 1.1 | 1.2 | 1.5 | 1.3 |
| Average real interest rate on domestic debt (in percent) | -1.4 | -1.8 | ... | -4.2 | 3.6 | -0.7 | 2.5 | 2.4 | 2.2 | 1.9 | 1.8 | 1.7 | 1.5 | 1.9 | 1.9 |
| Real exchange rate depreciation (in percent, + indicates depreciation) | -1.0 | 8.1 | -0.4 | -3.2 | 6.9 | -3.6 | ... | ... | ... | ... | ... | ... | ... | ... | ... |
| Inflation rate (GDP deflator, in percent) | 2.5 | 3.1 | 3.6 | 6.0 | 4.1 | 1.6 | 2.7 | 3.2 | 3.5 | 3.8 | 3.9 | 3.1 | 4.5 | 4.5 | 4.3 |
| Growth of real primary spending (deflated by GDP deflator, in percent) | -0.3 | 8.3 | -4.3 | 0.4 | 3.1 | 5.0 | 9.2 | -2.0 | 1.0 | 1.4 | 2.1 | 2.8 | 3.1 | 3.2 | 3.1 |
| Grant element of new external borrowing (in percent) | ... | ... | ... | ... | ... | 50.7 | 62.8 | 60.5 | 56.9 | 56.9 | 48.0 | 56.0 | 39.5 | 38.4 | ... |

Sources: Country authorities; and staff estimates and projections.

1/ Coverage of public sector debt is general government and gross debt.

Change in assets in 2015 and 2016 reflects the repayment of public domestic debt

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

3/ Revenues excluding grants.

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

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

6/ The residuals in 2016 was due largely to a decline in cash reserves of 2.9 percent of GDP.

## Table 5. Solomon Islands: Sensitivity Analysis is for Key Indicators of Public Debt 2017–37

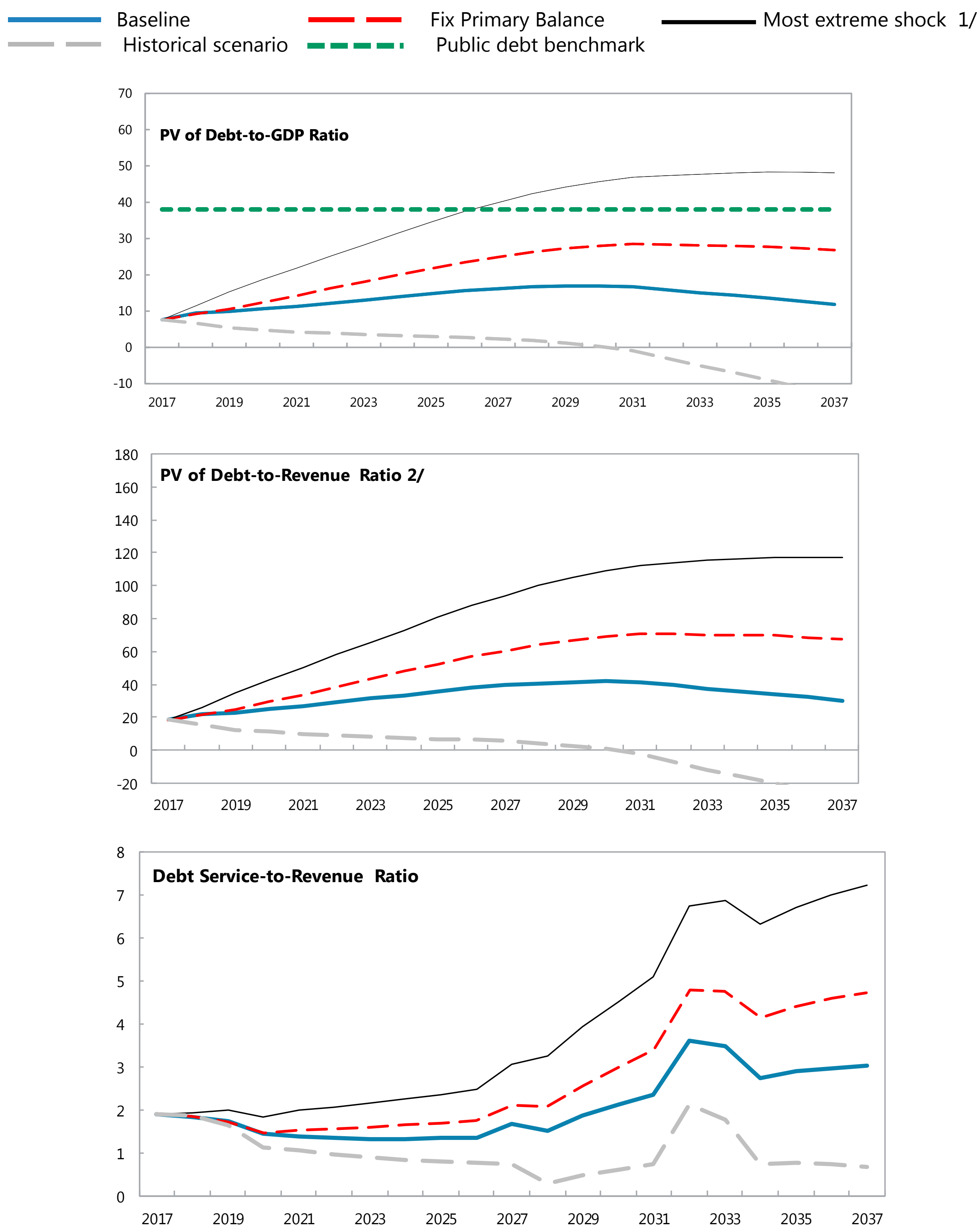
| | | Projections | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2027 | 2037 |
| **PV of Debt-to-GDP Ratio** | | | | | | | | |
| **Baseline** | 8 | 9 | 10 | 11 | 11 | 12 | 19 | 35 |
| **A. Alternative scenarios** | | | | | | | | |
| A1. Real GDP growth and primary balance are at historical averages | 8 | 6 | 4 | 2 | 1 | -1 | -4 | -4 |
| A2. Primary balance is unchanged from 2017 | 8 | 9 | 9 | 11 | 12 | 13 | 22 | 37 |
| A3. Permanently lower GDP growth 1/ | 8 | 10 | 11 | 12 | 14 | 15 | 29 | 73 |
| **B. Bound tests** | | | | | | | | |
| B1. Real GDP growth is at historical average minus one standard deviations in 2018-2019 | 8 | 11 | 15 | 18 | 21 | 24 | 41 | 72 |
| B2. Primary balance is at historical average minus one standard deviations in 2018-2019 | 8 | 8 | 7 | 8 | 9 | 10 | 16 | 34 |
| B3. Combination of B1-B2 using one half standard deviation shocks | 8 | 7 | 6 | 8 | 11 | 13 | 27 | 55 |
| B4. One-time 30 percent real depreciation in 2018 | 8 | 11 | 10 | 10 | 10 | 11 | 16 | 31 |
| B5. 10 percent of GDP increase in other debt-creating flows in 2018 | 8 | 15 | 15 | 16 | 17 | 17 | 23 | 37 |
| **PV of Debt-to-Revenue Ratio 2/** | | | | | | | | |
| **Baseline** | 19 | 22 | 24 | 26 | 28 | 30 | 46 | 89 |
| **A. Alternative scenarios** | | | | | | | | |
| A1. Real GDP growth and primary balance are at historical averages | 19 | 14 | 9 | 5 | 1 | -1 | -10 | -9 |
| A2. Primary balance is unchanged from 2017 | 19 | 20 | 22 | 25 | 29 | 33 | 54 | 94 |
| A3. Permanently lower GDP growth 1/ | 19 | 23 | 25 | 29 | 32 | 37 | 71 | 177 |
| **B. Bound tests** | | | | | | | | |
| B1. Real GDP growth is at historical average minus one standard deviations in 2018-2019 | 19 | 26 | 35 | 42 | 50 | 57 | 98 | 178 |
| B2. Primary balance is at historical average minus one standard deviations in 2018-2019 | 19 | 18 | 17 | 19 | 21 | 24 | 41 | 86 |
| B3. Combination of B1-B2 using one half standard deviation shocks | 19 | 16 | 13 | 19 | 25 | 31 | 65 | 138 |
| B4. One-time 30 percent real depreciation in 2018 | 19 | 25 | 24 | 24 | 25 | 26 | 39 | 80 |
| B5. 10 percent of GDP increase in other debt-creating flows in 2018 | 19 | 36 | 37 | 38 | 40 | 42 | 56 | 95 |
| **Debt Service-to-Revenue Ratio 2/** | | | | | | | | |
| **Baseline** | 2 | 2 | 2 | 1 | 1 | 1 | 2 | 6 |
| **A. Alternative scenarios** | | | | | | | | |
| A1. Real GDP growth and primary balance are at historical averages | 2 | 2 | 2 | 1 | 1 | 1 | 1 | 2 |
| A2. Primary balance is unchanged from 2017 | 2 | 2 | 2 | 1 | 1 | 1 | 2 | 6 |
| A3. Permanently lower GDP growth 1/ | 2 | 2 | 2 | 2 | 2 | 2 | 3 | 9 |
| **B. Bound tests** | | | | | | | | |
| B1. Real GDP growth is at historical average minus one standard deviations in 2018-2019 | 2 | 2 | 2 | 2 | 2 | 2 | 3 | 10 |
| B2. Primary balance is at historical average minus one standard deviations in 2018-2019 | 2 | 2 | 2 | 1 | 1 | 1 | 2 | 5 |
| B3. Combination of B1-B2 using one half standard deviation shocks | 2 | 2 | 2 | 1 | 1 | 1 | 2 | 8 |
| B4. One-time 30 percent real depreciation in 2018 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 8 |
| B5. 10 percent of GDP increase in other debt-creating flows in 2018 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 6 |

Sources: Country authorities; and staff estimates and projections.

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

2/ Revenues are defined inclusive of grants.

## Figure 3. Policy Adjustment Scenario: Indicators of Public Debt Under Alternative Scenarios, 2017–37 1/




Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2027.

2/ Revenues are defined inclusive of grants.

**Statement by Ms. Barron, Alternate Executive Director, Ms. Preston, Senior Advisor to the Executive Director, and Mr. Kikiolo, Advisor to the Executive Director of Solomon Islands**
February 16, 2018

## Context

The Solomon Islands is a small, fragile and a low-income country. The Solomon Islands is a group of almost 1,000 islands, stretching almost 1,000 miles. Across this widely-dispersed group of islands, 147 are inhabited by people speaking over 80 different languages from a mix of Melanesian, Micronesian and Polynesian cultures. The Solomon Islands is vulnerable to natural disasters, climate change, and commodity price shocks. Geographic dispersion and cultural differences add to development challenges in addressing infrastructure gaps and achieving political stability.

Despite these challenges, the economy has experienced sound growth in recent years. The Solomon Islands successfully completed the five-year IMF ECF Program in March 2016. Under the program, the Solomon Islands has made significant progress in achieving macroeconomic stability and strengthening institutions. The Central Bank has built up international reserve levels to around 9 months of import cover and key legislation has been implemented including the new '*Public Financial Management Act*' and the '*Central Bank of Solomon Islands Act'*. The successful conclusion on 30 June 2017 of the Regional Assistance Mission to the Solomon Islands demonstrates the progress made by authorities in returning peace and stability to the Solomon Islands, restoring law and order, rebuilding national institutions, and creating a safe and prosperous society for the citizens of the Solomon Islands.

Since the time of the Article IV consultation in Honiara in September 2017, a new Government is in place. The priorities of the new Government are to maintain political stability, reinvigorate economic growth through achievable investments in infrastructure, stabilize government finances by addressing the cash flow situation and instilling fiscal discipline.

## Economic Outlook

Authorities broadly agree with staff's assessment of economic activity. Growth in 2017 was in line with the authorities' expectation of around 3.2 percent largely driven by log exports, fishing revenues and construction.

Authorities are more optimistic than staff about the prospects for future growth, expecting average growth of around 4 percent for the period 2018-2020. Authorities expect that major projects such as the Gold Ridge mining development, the submarine fiber optic cable, and World Bank supported Tina River Hydro project will come on stream over the period. The authorities have factored them into their baseline projections as they are confident about the prospect of them coming to fruition while staff note these as upside risks. These projects will boost economic activity, providing more jobs in the mining, construction, communication and energy sectors and more mining revenue for the government. Public investments, particularly in national infrastructure projects such as roads, bridges and wharves, are key to driving broader-based growth than mining, tourism and agriculture.

Authorities are fully aware of the need to diversify the economy from a reliance on logging exports given the finite forest resources. While the timing of the decline of the logging sector is uncertain, authorities consider that growth in the mining sector should cushion declines in logging activities over the medium to long-term. Other potential sectors that can support medium to long-term growth are agriculture, tourism, and fisheries.

In agriculture, the government and donor partners are supporting plans to expand palm oil plantations further east on Guadalcanal. This should increase the plantation area almost twofold. In the fisheries sector, National Fisheries Development Ltd (NFD) has seen an increase in its fishing fleet, which should boost the volume that SolTuna Limited can process. In the tourism sector the new international airport at Munda in Western Province remains a work in progress but, if completed, Munda International airport should open direct routes for foreign tourists into the Western province, with pristine natural beaches.

**Fiscal**

Authorities take serious note of staff recommendations on fiscal policy. Key fiscal priorities for the Solomon Islands government are restoring fiscal discipline including by rebuilding cash buffers, while facilitating much needed investment in infrastructure. Authorities recognize that the fiscal position in 2017 has deteriorated due to increased expenditure in a number of areas and an over-optimistic outlook for revenue collections.

Authorities are working hard to finalize the 2018 Budget, which aims to curb recurrent expenditure in administrative areas, while protecting social spending and prioritizing growth enhancing spending to support productive sectors of the economy like infrastructure, tourism, agriculture, fisheries and mining.

The government is actively prioritizing cash payments including all payroll obligations to limit the spillover to the economy associated with late government payments and working on a strategy to deal with government arrears.

On the revenue side, the Government has done considerable work to tighten compliance and improve tax administration with technical support from PFTAC. This includes strengthening debt and tax management through the centralization of debt collection activities and the modernization of tax payment and lodgment facilities by introducing an online platform. In addition, authorities have conducted seminars to assist business understand their tax obligations and have recently appointed an audit advisor to examine cases of tax avoidance.

Authorities are actively considering further tax reforms to enhance revenue mobilization, including the introduction of a consumption-based tax and seeking to eliminate ad-hoc exemptions.

Authorities have re-established the ‘Core Economic Working Group’ of key bilateral partners and donors to support the Solomon Islands Government economic reform priorities. With the support of donors, the government will restore fiscal buffers, strengthening public financial management and progress key enabling legislation such as the Anti-corruption Bill, Constitutional Amendment Bill and Credit Union Bill.

Debt as a percent of GDP remains low at around 10 percent of GDP in 2017, one of the lowest in the Pacific, but will increase as the government undertakes much needed investment in infrastructure. The Government is investing in key projects such as the Honiara Road improvement project, new wharves under the National Transport Fund, the submarine cable project, and the Tina Hydro dam project which is expected to provide more than 200 jobs during construction and will greatly reduce carbon emissions.

Recognizing the infrastructure gap that means less than half of the population have access to electricity, and far fewer in rural areas, and 59 percent of households have to travel to access clean water, authorities and development partners are investing in a number of infrastructure projects and making them climate resilient. This includes roads, wharves, airstrips and urban waste management infrastructure that are in line with the National Development Strategy and Sustainable Development goals. In addition, in the energy sector the State-owned enterprise (Solomon Islands Electricity Authority) with the assistance of development partners has started building mini hybrid power stations in the provinces to improve household and business access to electricity.

As a country highly vulnerable to climate change and heavily exposed to shocks from a high frequency of natural disasters, authorities appreciated staff incorporating these factors in the Debt Sustainability Analysis. This is the first time that such a shock scenario has been incorporated into staff projections and authorities found it useful to get a sense of the potential impact a natural disaster can have on economic growth and debt dynamics. The analysis helps to reinforce the importance of having strong fiscal buffers to increase the government's flexibility to respond to natural disasters and to undertake investments in climate proof infrastructure to increase resilience.

## Monetary Policy

Authorities view the current monetary policy stance as appropriate. They have a focus on stability over competitiveness and view the basket peg exchange rate regime as working well. Authorities recognize IMF advice to increase the cash reserve requirement given the high levels of liquidity in the system. However, with contained credit growth and low inflation, authorities prefer a more gradual approach to avoid putting any unnecessary pressure on domestic banks. Authorities expect the need to finance new infrastructure projects and the issuance of its own Bokolo bills will also slowly soak up excess liquidity.

## Financial Sector

The National Financial Inclusion Taskforce (NFIT) established four working groups during 2017 to help drive the implementation of the National Financial Inclusion Strategy. Key work streams for these groups have been to increase financial literacy and financial education, introduce a pilot for voluntary savings products for the informal sector with the Solomon Islands National Provident Fund, open digital payment channels with the Inland Revenue Department and pilot digitization of the agricultural value chain including payments to coconut farmers and workers.

The Central Bank of Solomon Islands has been working hard to bring previously unbanked people into the formal financial sector. Authorities recognize that given low literacy levels, people need to be protected and have introduced two prudential guidelines aimed at protecting financial sector consumers from predatory practices and boosting their confidence in interacting with the financial system. The Central Bank of Solomon Islands will continue to monitor the growth of this sector and will introduce appropriate regulation and legislation when the market matures. Looking ahead, phase two of the strategy is to encourage greater usage of newly opened accounts.

**Technical Assistance**

Finally, the Solomon Islands authorities would like to thank development partners for their continued support and the mission team, led by Ms. Alison Stuart, for the candid and constructive discussions they have had during the article IV consultation. They value highly the advice and technical assistance received from the Fund and look forward to further constructive engagement in future.