



SOLOMON ISLANDS

February 2020

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE SOLOMON ISLANDS

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with Solomon Islands, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its February 5, 2020 consideration of the staff report that concluded the Article IV consultation with the Solomon Islands.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 5, 2020, following discussions that ended on November 11, 2019, with the officials of the Solomon Islands on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 21, 2020.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the International Development Association (IDA).
- A **Statement by the Executive Director** for the Solomon Islands.

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IMF Executive Board Concludes 2019 Article IV Consultation with the Solomon Islands

On February 5, 2020, the Executive Board of the International Monetary Fund (IMF) concluded the 2019 Article IV consultation¹ with the Solomon Islands.

The Solomon Islands economy grew by 3.9 percent in 2018 driven by a strong performance in logging, infrastructure spending, fisheries, agriculture, and manufacturing. However, growth is expected to have slowed to 2.7 percent in 2019 from weakening logging exports and the temporary pause in economic activity around the election period. Inflation remains subdued at an annual rate of 1.7 percent in August 2019. The current account deficit has widened with higher infrastructure imports but international reserves remain comfortable.

Monetary conditions are accommodative. Excess liquidity overhang has reduced, and credit growth slowed to 4.1 percent year-on-year at end of 2018.

The fiscal deficit widened to 2.7 percent of GDP in 2019 and is expected to widen further over the medium term. Public debt is currently low but rises over the medium term. Risks are on the downside with weak fiscal policy, decline in logging, spending pressures associated with the Pacific Games 2023, and spillovers from global trade tensions.

Executive Board Assessment²

Executive Directors welcomed the recent growth performance, the improvement in the fiscal position in 2018, low inflation and a comfortable international reserves cover. However, they noted that growth is slowing, fiscal pressures have begun to re-emerge and risks to the outlook

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.

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>.

are mostly on the downside. Directors urged the authorities to maintain fiscal discipline, strengthen governance and improve the business environment to sustain growth.

Directors emphasized that policy measures are needed to secure fiscal sustainability and build resilience, including to natural disasters through investment and contingency planning. They encouraged rebuilding the government cash balance, for which it would be essential to strengthen expenditure control and prioritize spending in line with the National Development Strategy. Sustaining efforts to boost revenues, increasing tax compliance, improving efficiency of the tax system and strengthening revenue administration would also bolster the fiscal position.

Directors urged the authorities to press ahead with expenditure reforms which would improve budget outcomes and the quality of spending through strengthening procurement planning, enforcing commitment controls, and greater transparency of the Constituency Development Funds. Directors stressed prudent management of development partner-financed infrastructure investments. Spending for the Pacific Games 2023 should be contained, financing should be transparent, follow procurement and public financial management best practices, and should be on grant or highly concessional terms in line with debt sustainability and implementation capacity. Directors welcomed the progress in anti-corruption efforts and encouraged stronger enforcement.

Directors considered that the basket exchange rate peg regime remains appropriate for Solomon Islands. They welcomed the review on the composition of the basket. Fiscal consolidation and structural reforms would help bring the external sector position closer to that suggested by medium-term fundamentals.

Directors emphasized the need to generate new sources of growth and viewed improved internet connectivity as an opportunity to foster private-sector development and public sector service provision. Harnessing benefits from connectivity would require improvements in the regulatory framework, and complementary investments in infrastructure and human capital. Progress in strengthening governance should continue where improvements in the legislative framework, regulation and oversight would be necessary to create a conducive environment for mining and avoid governance problems.

Directors encouraged the authorities to sustain progress on financial sector reforms. The strengthening of the AML/CFT framework would help alleviate risks to correspondent banking relationships.

Table 1. Solomon Islands: Selected Economic Indicators, 2015–2024

Per capita GDP (2017): US\$2,144 Population (2017): 613,712										
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
					Proj.	Proj.				
GROWTH AND PRICES										
Annual percentage change unless otherwise indicated										
Real GDP	2.5	3.2	3.7	3.9	2.7	2.5	2.7	2.8	2.8	2.9
CPI (period average)	-0.6	0.5	0.5	3.5	1.9	2.3	2.9	3.5	3.7	4.0
CPI (end of period)	3.5	-2.2	2.1	3.9	2.2	2.4	3.3	3.5	3.9	4.0
GDP deflator	3.1	3.7	1.9	3.5	1.4	2.4	3.0	3.4	3.7	4.0
Nominal GDP (in SI\$ millions)	9,139	9,780	10,330	11,099	11,553	12,130	12,839	13,643	14,544	15,556
CENTRAL GOVERNMENT OPERATIONS										
In percent of GDP										
Total revenue and grants	47.9	43.2	43.1	45.3	39.0	36.5	36.7	37.2	38.3	37.3
Revenue	35.1	31.8	32.8	34.3	30.1	29.8	29.6	29.5	29.2	29.1
Grants	12.9	11.4	10.2	11.0	8.8	6.7	7.2	7.7	9.1	8.2
Total expenditure	48.0	47.1	47.5	44.6	41.6	40.2	41.6	42.2	43.9	42.1
excluding grant-funded expenditure	35.1	35.7	37.3	33.6	32.8	33.5	34.4	34.4	34.8	33.9
Recurrent expenditure	33.7	32.1	31.8	33.0	29.8	28.6	28.7	28.9	29.0	29.1
Development expenditure	14.3	15.0	15.8	11.6	11.8	11.7	12.9	13.3	14.9	13.0
Unrecorded expenditure 1/	0.2	-0.6	-1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	0.0	-3.9	-4.5	0.7	-2.7	-3.7	-4.8	-5.0	-5.6	-4.8
Foreign financing (net)	-0.2	0.3	0.8	0.2	0.8	2.8	3.6	3.5	3.7	2.7
Domestic financing (net)	0.4	3.0	2.1	-0.8	1.9	0.9	1.2	1.5	1.8	2.1
Central government debt 1/	7.9	9.5	9.4	11.6	14.9	18.9	22.8	26.9	30.0	33.1
MACROFINANCIAL										
Annual percentage change (end of year)										
Credit to private sector	16.7	12.1	6.4	4.1	4.9	5.5	5.7	6.0	5.0	4.5
Broad money	15.0	13.4	3.5	6.8	2.1	2.4	5.1	4.1	2.6	3.3
Reserve money	23.5	14.5	7.5	10.5	0.0	4.8	6.9	2.2	2.6	1.5
BALANCE OF PAYMENTS										
In US\$ millions unless otherwise indicated										
Trade balance	-93.5	-71.7	-81.7	-69.4	-156.0	-161.6	-219.9	-280.4	-335.8	-306.3
(percent of GDP)	-8.1	-5.8	-6.4	-5.0	-11.0	-10.8	-13.9	-16.7	-18.8	-16.0
Current account balance	-35.3	-48.8	-62.8	-62.5	-121.9	-120.2	-168.4	-219.1	-264.2	-233.6
(percent of GDP)	-3.0	-4.0	-4.9	-4.5	-8.6	-8.1	-10.7	-13.1	-14.8	-12.2
Foreign direct investment	27.6	36.0	50.0	43.1	48.5	53.4	61.4	65.9	68.1	72.4
(percent of GDP)	2.4	2.9	3.9	3.1	3.4	3.6	3.9	3.9	3.8	3.8
Overall balance	5.3	-5.9	63.2	36.2	-9.5	-0.5	-4.8	-32.3	-38.0	-27.5
Gross official reserves (in US\$ millions, end of period) 2/	519.6	513.6	576.9	613.1	601.5	600.8	595.7	563.1	525.1	497.6
(in months of next year's imports of GNFS)	10.0	9.1	9.3	8.5	8.1	7.6	7.0	6.2	5.4	5.2
Net official reserves (in US\$ millions, end of period)	505.6	503.5	566.7	603.0	593.5	593.0	588.2	556.0	518.0	490.5
(in months of next year's imports of GNFS)	9.7	8.9	9.1	8.4	8.0	7.5	6.9	6.1	5.3	5.1
EXCHANGE RATE (SI\$/US\$, end of period)	8.1	8.2	7.9	8.1	8.3	...	...	...	...	...
Real effective exchange rate (end of period, 2010 = 100)	127.3	127.8	126.3	130.8	139.5	...	...	...	...	...
MEMORANDUM ITEMS:										
Cash balance (in SI\$ millions)	694	412	343	337	240	129	-26	-238	-512	-846
in months of recurrent spending	3.6	2.0	1.5	1.3	0.9	0.5	-0.1	-0.8	-1.6	-2.5
SIG Deposit Account (In addition to cash balance, in SI\$ millions)	140	140	140	140	140	140	140	141	142	143
Broader cash balance (=Cash balance+ SIG Deposit Account; in SI\$ millions)	834	552	483	477	380	269	114	-97	-370	-703
in months of total spending 3/	3.1	1.9	1.5	2.1	1.4	1.0	0.5	-0.1	-0.7	-1.5
Public domestic debt, including arrears (in SI\$ millions)	43	43	193	245	502	613	768	966	1,219	1,533

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

1/ Includes disbursements under the IMF-supported programs.

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

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



SOLOMON ISLANDS

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

January 21, 2020

KEY ISSUES

Context. Solomon Islands has made substantial progress since the Tensions in the early 2000s but faces considerable economic and governance challenges and is highly vulnerable to natural disasters. Finding new sources of growth is becoming urgent with the decline in logging. Budget pressures are re-emerging; revenues have weakened while spending has picked up, including a sharp increase in payroll. Governance challenges stem from weak oversight of the resource sectors, a lack of transparency and a need to strengthen public financial management.

Article IV Consultation. The consultation focused on similar issues to last year—restoring fiscal buffers to build resilience, strengthening public financial management and public investment management, setting a medium-term fiscal strategy, improving governance, improving exchange rate management and building conditions for sustainable growth.

Policy Recommendations:

- Take fiscal policy measures to sustain a fiscal cash balance at or above two months of total spending. This requires both revenue and expenditure measures, with spending prioritized in line with the National Development Plan. Pacific Games investment should be contained and should aim at delivering legacy benefits.
- Develop a holistic approach to medium-term fiscal policy by setting a realistic spending envelope and establishing a medium-term revenue strategy. Together with strengthened budget planning and expenditure control, this would provide greater budget predictability and support natural disaster contingency planning.
- Maintain the exchange rate basket peg but improve exchange rate management by reviewing the basket's composition on a regular basis.
- Strengthen enforcement of governance standards, apply the mining fiscal regime rigorously, improve transparency and advance the anti-corruption agenda.
- Generate new sources of growth. The new undersea internet cable could open up opportunities for development with sound regulatory framework, and appropriate investment in human capital and physical infrastructure.

Approved By
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Discussions took place in Honiara during October 30–November 11, 2019. The staff team comprised Alison Stuart (head), Stella Kaendera, Charlotte Sandoz, and Vybhavi Balasundharam (all APD). Leni Hunter (Resident Representative, Pacific Islands) and Michael Kikiolo (OED) joined part of the mission. Executive Director Nigel Ray (OED) attended concluding meetings. The mission met with Prime Minister (PM) Hon. Manasseh Sogavare, Minister of Finance and Treasury Harry Kuma, Central Bank Governor Luke Forau and other government officials, representatives from the private sector, civil society organizations, and development partners. Haopeng Xu, Nadine Dubost, and Kristine Lалуces provided research and editorial assistance for this report.

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CONTEXT

1. **Solomon Islands is a small low-income economy reliant on an over-exploited logging industry.** Significant progress in rebuilding institutions has been made since the end of the Tensions (1998-2003). But after the end of an IMF program in 2016, the fiscal position deteriorated and cashflow problems emerged.
2. **There are substantial development challenges.** With the logging industry facing depletion, new sources of growth are needed. Preserving macroeconomic stability, strengthening transparency and governance, improving the business environment, and progressing financial market development are required to support new growth areas and to meet the Sustainable Development Goals (Figure 1, Appendix I). Increased internet connectivity could help generate significant growth opportunities, if harnessed well.
3. **Governance problems are long standing.** They stem from poor management of the logging and newly-emerging mining sectors, a lack of transparency including in Constituency Development Funds (CDFs are payments to MPs for rural development), and weak public financial management (PFM). Governance problems are exacerbated by remoteness, geographical dispersion, a lack of local services provision, and strained capacity. This results in fiscal leakages, weakens growth and undermines stability.
4. **The 2019 general election halted much economic activity for four months at the beginning of the year.** Voters and Members of Parliament returned to remote constituencies in December 2018 ahead of April's election, economic activity slowed, and the government was in caretaker mode, limiting spending and revenue collection and halting progress on reforms.
5. **The new government took office at end April 2019.** The Prime Minister, Mr. Manasseh Sogavare, is an experienced former PM and Minister of Finance; and there is continuity in the Ministry of Finance and Treasury (MOFT) with Mr. Harry Kuma (former Permanent Secretary) appointed as Finance Minister. Since the new government was elected, there have been two main developments. In September 2019, the authorities cut ties with Taiwan Province of China, established diplomatic ties with China and began negotiating for the provision of grants and infrastructure investment. The government's agenda is also focused on hosting the 2023 Pacific Games (PG) which requires significant investment.

RECENT DEVELOPMENTS

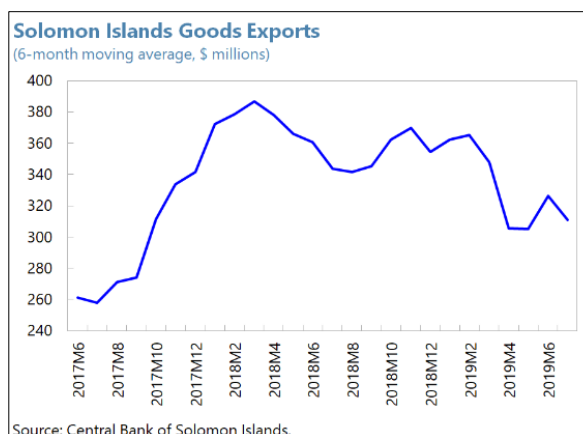
Economic indicators have been favorable but there are signs of a slowdown in 2019 and strains on the government's budget are re-emerging.

6. **Economic activity held up well in 2018 but growth slowed in 2019.** Real GDP growth picked up to 3.9 percent in 2018, boosted by a strong performance in logging, infrastructure spending, fisheries, agriculture, and manufacturing. However, more recently, logging exports have

weakened with lower demand from China (Text chart, and Figure 2). The temporary pause in economic activity around the election also subtracted from growth in 2019. Growth is expected to slow to 2.7 percent in 2019.

7. The current account deficit (CAD) is widening with higher infrastructure imports.

The CAD was around 4.5 percent of GDP in 2018. Exports of logs grew by 20 percent and accounted for more than 70 percent of total exports in 2018. However, import growth outpaced exports, with imports for development-partner-financed infrastructure projects increasing and set to continue in 2019. Reserves import cover fell back but remained comfortable, at 8.5 months in 2018.



8. Fiscal pressures eased in 2018 but are mounting again post-election. In 2018, an overall surplus of 0.6 percent of GDP was recorded due to higher than expected revenues and slower execution of major infrastructure projects, but spending on tertiary scholarships, shipping grants and Constituency Development Funds (CDFs) remained high. The authorities eliminated domestic arrears and rebuilt the broader cash balance to two months of total spending.¹ But logging revenues have declined by 15 percent in 2019H1 and other revenues weakened around the election. Notwithstanding excise increases and other revenue measures, revenues overall are likely to be sharply lower this year. Spending has picked up in recent months, with a sharp increase in the public sector payroll and staff project an overall deficit of 2.7 percent of GDP in 2019.

9. Inflation is subdued and credit growth is lackluster alongside weakening activity.

Inflation peaked at 4.4 percent at end-2018 partly due to increased excise duties but subsided to 1.7 percent in August 2019. Broad money growth has slowed markedly during 2019, reflecting lower money demand around the election and has reduced the excess liquidity overhang. Credit growth slowed to 4.1 percent growth year-on-year at end of 2018 (Figure 4) and is projected at 4.9 percent in 2019.

10. Financial sector vulnerabilities have eased with the re-establishment of a correspondent banking relationship for a domestic bank (see ¶31). The CBSI has taken actions to strengthen prudential guidelines. NPLs have continued to increase in 2019 to 10.3 percent, amplified by the economic slowdown and delays in government payments, but provisioning has also increased. Profitability is solid, generated by high (and uncompetitive) interest margins (Table 5).²

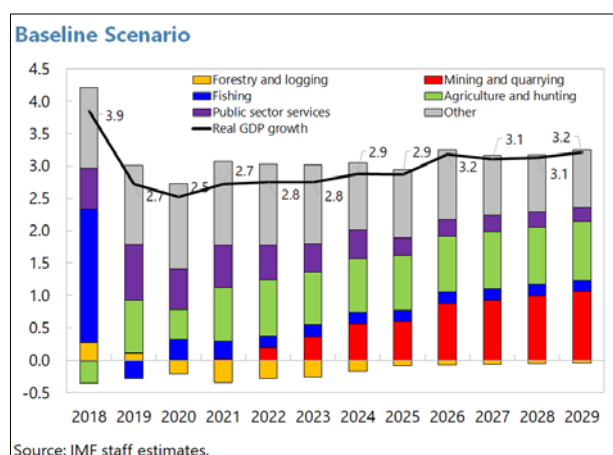
¹ The broader cash balance is the sum of government deposits held at CBSI and the commercial banks minus unpaid payment orders and unrepresented checks, plus reserves in the government consolidated deposit account (SI\$140mn). The 2016 Article IV proposed monitoring the broader cash balance as a proportion of total spending with a floor of two months for cash management.

² Average interest rates on loans remain high at 10.6 percent (in September), with interest rates on fully collateralized personal loans exceptionally high at around 13–17 percent, indicating a continued lack of competition among banks.

OUTLOOK, RISKS, AND VULNERABILITIES

An Uncertain Outlook

11. The growth outlook is highly uncertain with logging in decline. Effective implementation of the government's sustainability policy would imply a halving of logging activity by 2023. In the near term, donor-supported projects and PG investment will cushion the impact from tapering of logging but major new sources of growth will take time to be fully established, especially as the mining sector is in its infancy. Staff's baseline projection includes a somewhat more gradual tapering of logging activity than the government's projection, as it will be challenging to police full implementation of the sustainability policy across geographically dispersed islands. The decline in logging is partly offset by infrastructure spending and then with mining activity gradually coming on stream. Growth is expected to average 2.7 percent over 2019-2024.³ The current account deficit is likely to almost double to 8.6 percent of GDP in 2019 and to continue widening as imports for infrastructure grow (financed partly by aid and concessional borrowing flows). Inflation is projected to remain contained in 2019 and 2020 with lower global commodity prices and to pick up gradually in the outer years to around 4 percent, in line with its historical average.



12. On unchanged policies, without an additional effort to constrain spending, pressures on the government's budget re-emerge. Revenues fall back with reduced logging exports. In line with past post-election experience (Figure 6), staff expect heightened pressure to maintain CDF and other spending and for the offsetting large social spending cuts to be unattainable. The overall deficit is expected to widen each year, reaching 3.7 percent of GDP in 2020 and 4.8 percent of GDP in 2021. Without adjustment measures, the cash balance would be exhausted by 2022 and new domestic arrears would accumulate. The weak fiscal position increases vulnerability of the economy to shocks, including natural disasters. Debt sustainability is assessed to be at moderate risk.

13. Risks are skewed to the downside (Appendix III). Although mining, internet cable development and other essential infrastructure could open up opportunities, these are outweighed by the risks from lax fiscal policy, the decline of logging, and global trade tensions weighing on Chinese demand and adversely affecting Solomon Islands exports. Graduation from LDC status by 2024 could also affect exports to the EU. In any year, there is a one in seven chance that the

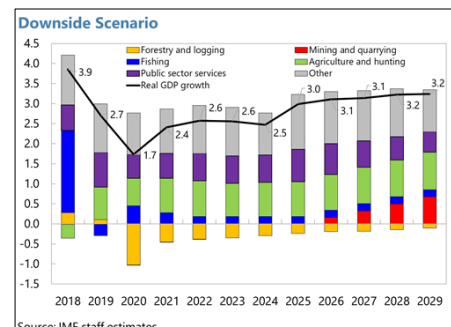
³ As in previous years, staff adjust medium term growth downwards by 0.3pps to take account of the average annual impact of natural disasters.

Solomon Islands will face a severe natural disaster, reducing the annual growth rate by 0.3 percentage points a year and adding to vulnerability. There is also a risk that PG spending is not fully covered by grants as financing for a large proportion of the proposed investment has yet to be identified.⁴

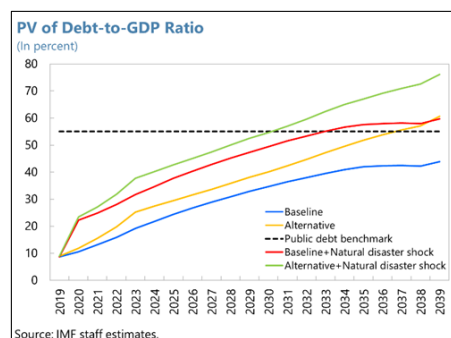
Text Table 1. Solomon Islands: Summary Risk Assessment			
High Vulnerability, Risks Weighted to the Downside		Likelihood	Impact
Upside	1. Reopening of Gold Ridge mine, and nickel and bauxite projects start up.	Medium	High
	2. Positive spillovers from large infrastructure projects.	Medium	High
	3. Internet Undersea Cable is highly effective and substantially improves connectivity.	High	High
Downside	1. Fiscal policy slippage, including spending on Pacific Games.	High	High
	2. Rising protectionism and retreat from multilateralism has a knock-on effect on logging and other trade.	High	High
	3. Weaker-than-expected global growth, including China in the near term with further escalation of trade tensions.	High	High
	4. Sharp swing in energy prices.	Medium	Medium
	5. Loss of correspondent banking relationship.	Medium	High
	6. A natural disaster causes severe economic damage. Disasters occur with higher frequency and severity.	High/ Medium	High

14. To demonstrate the growth risks, staff developed an illustrative downside scenario.

This scenario for growth incorporates a steeper decline in logging, a 3-year delay in the reopening of Gold Ridge mine and the beginning of the nickel and bauxite projects, and external debt financed PG investment. This results in a steep decline in growth in 2020 and lower growth over the medium term by around 0.4 percentage points, at 2.4 percent on average.



15. Public debt is currently low but rises over the medium term. In staff’s baseline, indicators only marginally breach the thresholds. But, in staff’s downside scenario, debt pressures build, and staff judge the overall risk of debt distress to be moderate (see debt sustainability analysis).



⁴ Government documents suggest PG 2023 costs of SI\$2 billion (\$250mn), to be raised through external grants. The baseline assumes grant finance of less than SI\$2bn. The downside scenario assumes the full amount is loans.

Authorities' Views

16. The authorities agreed with staff's assessment of the outlook and balance of risks. The slowdown in China was already resulting in a weakening in logging activity, and it would be cut back further with the implementation of the sustainable logging policy. This could result in a significant reduction in economic activity and revenue. In the near term, the authorities expect donor-supported infrastructure projects and fishing to support activity. Over the medium term, mining activity would likely emerge as a driver of growth although the reopening of the Gold Ridge mine had been further delayed, and other mining activities are at an early stage of development. The authorities are keen to establish policies to promote growth in other sectors, including agriculture, tourism and fisheries. The authorities are mindful of the risks to the economy and the need to strengthen the fiscal position to reduce vulnerabilities. They noted that they would seek to contain any fiscal risks from the hosting of the Pacific Games and would focus on reforms to improve revenue mobilization, as well as aiming to strengthen budget planning, spending discipline and procurement controls.

POLICY DISCUSSION: MAINTAINING STABILITY

Staff emphasized the need for stronger fiscal management and near-term fiscal adjustment, setting a medium-term fiscal strategy, improving exchange rate management, strengthening financial stability, improving governance and building the conditions for sustainable growth.

A. Fiscal Management and Resilience Building

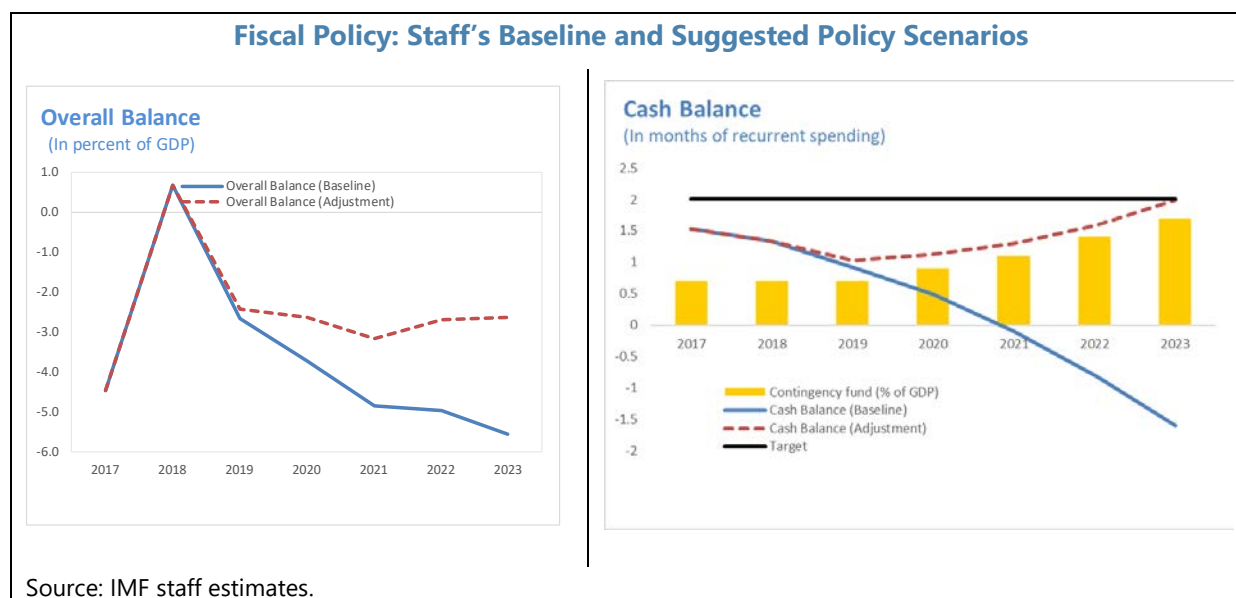
Staff's Assessment

17. Policy measures are needed to keep fiscal buffers above a minimum level and channel resources to growth-enhancing spending. Staff recommends sustaining a broader cash balance of around 2 months of total spending. This would help handle day-to-day cash management and to respond to small shocks. As noted above, without policy measures, staff's baseline projects the cash balance to erode to zero by 2022. Beginning with the 2020 Budget, the following measures compared to the staff's baseline would restore the broader cash balance (Table 7):

- **Revenues.** Recovery of tax arrears, as well as strengthened revenue administration and compliance have shown some signs of success, and it would be helpful to sustain the current momentum. Maintaining the tax reference price for logs in line with world market prices would reduce the scope for transfer pricing. For the mining sector, it is important to make sure that the prices used to determine mining royalties are set at the right level (i.e. not too low); and scope for international profit shifting is curtailed.
- **Expenditures.** Better planning and a focus on quality spending, prioritized in line with the National Development Strategy, would be less disruptive than large ad hoc cuts to ministries budgets to offset big changes in the payroll and pressures from higher CDF spending. The

Ministry of Finance should be supported to enforce budget discipline in line ministries, imposing commitment controls and staging the release of warrants.

- **These measures should only moderately affect growth.** Fiscal multipliers are likely to be low, as the measures aim at improving the quality of spending, tackling tax debts and improving efficiency.
- **PG and other infrastructure investment.** The staff's baseline projects 4.7 percent of GDP annual infrastructure spending based on projects in the pipeline. But the authorities aim to scale up by a further 2 percent of GDP a year in loan-financed projects. The PG investments should be grant-financed and contained so as not to crowd out urgent development needs and should deliver legacy benefits. The authorities must be in the driving seat with respect to investment decisions and borrowing, making sure that all projects fit with their development plans, that the payoff of the projects is adequate and that any attendant risks are properly managed. External financing needs to be transparent, follow good selection, procurement and public financial management best practices, and be on grant or highly concessional terms, in line with debt sustainability and implementation capacity. Consideration of maintenance costs will also be important.



18. Fiscal target. Once the cash balance is restored, the debt limit could be supplemented by an operational fiscal target of an overall deficit of 1.5 percent of GDP to guide the annual budget.⁵ Such a target would be transparent and would strike a balance between containing debt levels, addressing infrastructure needs, and providing for priority spending in health and education (see 2017 Staff Report).

⁵ Currently, the debt limit is not binding with debt at 11.5 percent GDP compared to the nominal debt target of 35 percent of GDP.

B. Medium-Term Fiscal Policy Strategy

Staff's Assessment

19. A comprehensive approach to medium-term fiscal policy would be beneficial. This would guide policy goals, identify a realistic spending envelope, and set a medium-term revenue strategy (MTRS). Greater predictability for departmental spending would shift the focus from short-term to longer-term goals. It would also enable the authorities to begin gradually building a buffer for natural disasters. Staff's work suggests that a buffer of around 2.5 percent of GDP would be sufficient to cope with a severe disaster.⁶ While that looks ambitious in the near term, some progress could be made towards this goal with the fiscal adjustment path suggested by staff (see chart).

20. Tax reform is an opportunity to generate revenue more efficiently, fairly and equitably. A MTRS would help set policy goals, provide a governance structure to coordinate reforms, engage stakeholders and foster cooperation among development partners. Plans to introduce a VAT law are underway with a policy paper to Cabinet expected in early 2020. Articulating the policy intent for the new VAT, as well as other reforms, taking into account the fiscal regime for the mining sector, and building consensus will be important. The reforms should be revenue neutral (at least). The IMF staff can provide advice and work in coordination with the ADB who are working on VAT. The authorities should ensure there is adequate funding and implementation capacity in Inland Revenue and Customs. Cementing the progress already made on improving revenue administration, compliance, and reducing tax arrears would help underpin the fiscal position over the medium term. The introduction of a large tax-payer office and forthcoming tax legislation should also improve compliance.

21. Public financial management weaknesses need to be addressed. Priorities include finalizing the regulations under the PFM Act, developing short term liquidity forecasts, improving budget planning, preparing procurement plans and ensuring that budget allocations are aligned with development priorities. The MOFT review of the payroll and allowances will help to get a handle on whether departments' staffing and wage expenses are warranted. A stocktaking of arrears is needed to clear outstanding obligations and formulate a plan to prevent further accumulation.

22. Improving the efficiency of public investment management is important given the authorities' desire to scale up investment, a large infrastructure gap and scarce resources. As highlighted in the 2018 Article IV Consultation, Appendix VI, there are shortcomings in many aspects of the project management cycle, including project appraisal, a lack of systematic cost-benefit analysis, and a lack of transparency in the project selection and procurement process.

23. Greater transparency of CDFs. The review of the CDF Act should be completed quickly with the supporting regulations developed and implemented. Citizen participation in CDF allocation,

⁶ See Nishizawa, H., Roger, S., and Zhang, H. "Fiscal Buffers for Natural Disasters in Pacific Island Countries" IMF working paper No. 19/152.

transparency in use of CDF resources, procurement rules, regular monitoring and reporting, and clarity on asset ownership would promote discipline in the use of CDF funds. To demonstrate that CDF spending is in line with the National Development Strategy, the Budget should report on the extent to which CDF spending is promoting the main social development areas. Capacity issues at the constituency level also need to be addressed. Staff welcomes plans to transition away from cash payments of CDF funds.

Authorities' Views

24. The authorities shared the staff's concerns that fiscal pressures were reemerging following the election, and this was challenging as fiscal buffers are low. Measures have been identified in the FY 2020 budget to strengthen revenue mobilization and improve the efficiency of spending. Revenue measures include clearing of tax and non-tax arrears and capping discretionary tax exemptions. Spending measures include better planning and prioritization of spending plans and identifying some savings from the recurrent budget to reallocate to development spending which had been cut back. The authorities affirmed continued progress with tax reforms and the review of the CDF Act and regulations.

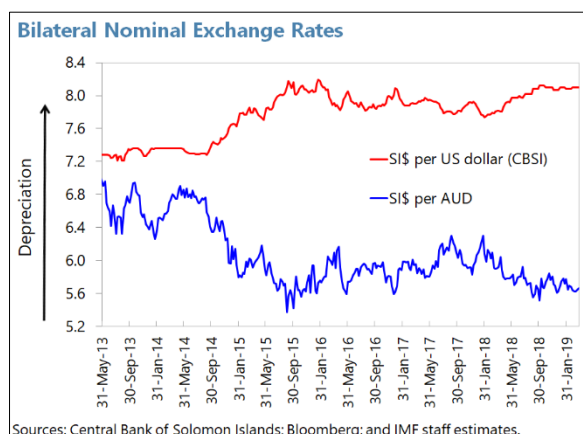
25. On large infrastructure projects, including spending associated with preparations for the Pacific Games, they noted that while not all funding had been identified, they were seeking grant financing from a range of bilateral development partners. The authorities agreed with the cautionary message to strictly prioritize projects, follow good procurement practices, with financing on transparent terms and provided as grants or highly-concessional loans.

C. Monetary and Exchange Rate Policy

Staff's Assessment

26. The monetary policy stance is appropriate for current conditions, although the transmission channels are weak. Reserve requirements were raised earlier in 2019. Inflationary pressure has dissipated, the growth outlook is uncertain and credit growth is moderate. Excess reserves are structural, in part reflecting lags between donor inflows and spending. Addressing constraints on National Provident Fund investment abroad, stemming CBSI valuation losses, and tackling weak investor protection and uncertain property rights would reduce excess liquidity, enable collateralized lending, and improve monetary policy effectiveness.

27. The basket exchange rate peg is an appropriate nominal anchor. There are few alternative workable options, given CBSI balance sheet constraints, an underdeveloped government securities market and the weak interest rate transmission channel. The CBSI tightly manages fluctuations against the U.S. dollar (Text chart). Allowing more volatility against the U.S. dollar and less against the Australian dollar (in line with basket weights) would support the economic rebalancing away from logging and would help reduce the volatility of imported food price inflation. The logging sector should be able to hedge foreign exchange risk. Exchange rate management can be enhanced by more regular reviews and the CBSI publishing the composition of the basket. Staff welcomes the review of the exchange rate basket currently underway at CBSI.



28. The external sector position is assessed to be weaker than suggested by medium-term fundamentals and desirable policies. In 2019, the current account (CA) deficit was weaker than the norm by 4.2 percentage points, equivalent to an overvaluation of the real effective exchange rate (REER) of around 11 percent, although the REER methodology pointed to a bigger overvaluation of around 19 percent (Appendix V). Reserve coverage is currently adequate. However, the current account deficit is likely to widen in 2020 with higher infrastructure spending. Fiscal adjustment, strict prioritization of investments, seeking out grant financing and structural reforms would help narrow the current account gap over the medium term and improve competitiveness, which is essential for other growth sectors to develop. Managing the exchange rate in line with basket weights (rather than the U.S. dollar) would lessen the erosion of competitiveness.

Authorities' Views

29. The authorities viewed the basket exchange rate peg as working well. The review of the exchange rate basket would consider whether the basket's composition and currency weights remain appropriate or need modest adjustment; and it would look at the management of exchange rate operations. The CBSI recognized the importance of sustaining competitiveness, especially in a challenging environment where the drivers of growth were changing. The prospective widening of the current account deficit largely reflects investment in infrastructure and a sizeable proportion of inflows would be grants or financed on concessional terms. The CBSI expressed interest in following up on previous technical assistance on reserve and exchange rate management with some targeted support on operations.

D. Financial Stability and Financial Sector Reforms

30. The establishment of a correspondent banking relationship (CBR) for a domestic bank at end-2018 has lessened immediate financial stability risks. The difficulties of restoring a

relationship highlighted the importance of taking remedial actions to address material gaps in governance and risk management within the bank and ensuring the effectiveness of the AML/CFT framework. Looking forward it would be helpful to continue to seek additional solutions to reduce correspondent banking pressures. Addressing gaps in the quality and effectiveness of governance and risk management in the banking system should continue, as well as efforts to quickly develop prudential standards for governance and “fit and proper”. While the domestic bank currently does not pose a financial stability risk, staff encourages a regular assessment of the bank’s business plans to ensure it remains profitable from operations excluding logging. Contingency plans are also needed in case problems reemerge. The CBSI could usefully contribute to regional initiatives to reduce CBR pressures.

31. The Asia Pacific Group 2019 Mutual Evaluation found gaps in the effective implementation of the AML/CFT framework. In particular, they highlighted weaknesses in AML/CFT supervision, the application of preventative measures, a lack of transparency of the beneficial ownership of legal entities, and the application of targeted financial sanctions. The CBSI is already taking important steps to address the findings of the Mutual Evaluation, including increasing the staffing of the Financial Intelligence Unit (FIU) from 2 to 10 people to cover both the financial and non-financial sectors. The clarification of reporting lines within the CBSI is welcome and will address some APG recommendations. Staff encourages the authorities to work together in developing prudential guidelines on operational risk and governance and drafting a new risk management standard for effective AML/CFT supervision. Progress on the anti-corruption agenda would also help address some weaknesses (paragraph 39).

32. Financial sector reforms should continue. A high priority should be given to eliminating the backlog of financial sector legislation. Financial sector legislation in Solomon Islands is outdated, diminishing effective supervision and undermining capacity to respond effectively to risks to the financial system. Staff welcomes the government’s decision to fast track a review of the Credit Union Act and the Insurance Act.

33. The new Development Bank (DBSI) should be subject to rigorous supervision standards and have a strong governance structure so that it does not add to fiscal risks. The focus of DBSI on lending to rural agriculture projects for stimulating activity in the rural areas and promoting financial inclusion, SMEs and diversification is welcome. However, experience, including for the Solomon Islands, shows that development banks’ performance is mixed with a potential to add to fiscal and financial stability risks. The DBSI should have private sector involvement, be supervised by CBSI and governed by independent board members.

Authorities’ Views

34. The authorities agree to the need to further strengthen financial oversight and secure additional CBR for the domestic bank. The CBSI has strengthened its prudential guidelines and is substantially increasing the staffing of the Financial Intelligence Unit, following the recommendations of the Asia Pacific Group Mutual Evaluation on AML/CMT framework. They are also interested in technical assistance in financial analysis and stress testing. The authorities are

exploring options to secure another CBR for the systematically important domestic bank. They are supportive of the development of a regional know-your-customer utility and will actively participate in this effort.

PROMOTING GROWTH

A. Encouraging New Growth Areas and Structural Reforms

Staff's Assessment

35. The slowdown in logging activity could have a significant economic impact. Logging contributes to 20 percent of domestic revenue, 60 percent of exports, 32 percent of foreign exchange receipts and five thousand jobs. Household consumption is linked to cycles in logging.

36. Agriculture, fisheries, tourism and the mining sectors have potential as growth sectors—and mining has the largest potential. Staff's work suggests that there is some scope for export diversification and the development of new markets to help rebalance growth away from reliance on the logging sector. The mining sector and exports of gold, nickel and bauxite would contribute. In agriculture, there is some scope for import substitution and specialization in niche markets. Improved connectivity and transport infrastructure could also help boost tourism over the longer term.

37. A better business environment would help diversify activity and support sustained growth. Improving sanitation, transport, communication and energy services would facilitate diversification. Enforcement of contracts, procedures for trading across borders, insolvency resolution and access to finance are areas for improvement. Solutions to challenges posed by communal land-ownership are important but there are no quick fixes. Long-term leases have been workable in some cases. Granting all community members landowning rights could improve equity and reduce concerns over commercial use. Promoting development of a land registry should help once rights are established. Increased connectivity, with the completion of the undersea internet cable, could boost development of new sectors, especially if the cost of service provision declines. Opportunities include the marketing of tourism, boosting agricultural productivity, and easing the spread of knowledge in health and education. Digitalization and registration could potentially improve record keeping, revenue collection, open access to credit and help tackle property rights issues. SOEs have performed well in recent years, with high profits from monopoly positions—stronger regulation or other initiatives could help promote greater affordability.

38. Harnessing the potential from connectivity requires careful management. Expanded connectivity opens up countries and financial systems to cyber-crime and security risks. PFTAC is supporting supervisors to develop basic cyber-security knowledge. New Zealand and the World Bank are also focused on addressing the risks. Creating favorable conditions for technology

adaptation also requires investment in human capacity, a sound regulatory framework, interoperability, a level playing field; and encouraging regional approaches could help.⁷

39. Progress should continue on strengthening the anti-corruption framework to facilitate the effective detection, investigation and prosecution of corruption.^{8,9} The Anti-Corruption Act establishes an independent commission to investigate and prosecute offenders. An anti-corruption secretariat has been set up in the Prime Minister’s Office to oversee the appointment of the board for the independent commission. Appointment of independent commissioners is underway and would safeguard the credibility of the anti-corruption framework. Once the commissioners are in place, establishing an asset disclosure monitoring system for MPs and officials, as identified by UNCAC peer reviews, will be important to curtail fraud and address some shortcomings identified in the mutual evaluation.

Authorities’ Views

40. Bridging the transformation from logging to other activity will require careful policy management. Greater emphasis is being placed on creating an effective legislative environment with strong enforcement. For example, the new mining legislation is being updated and is in its final stages of drafting. The authorities are cautiously optimistic about the economic potential from improved connectivity through the new undersea cable, although it will be challenging to ensure that lower costs are passed on to consumers. In preparation for the cable, the government has initiated processes to develop broader risk mitigation strategies to manage the cyber and financial systems risks associated with expanded connectivity.

B. Governance

Staff’s Assessment

41. The environmental and corruption problems that plague the logging sector could spread to mining, undercutting the potential wealth gains. The poor track record of mining development results in fiscal leakages, weakens growth and undermines stability. Ensuring that there is transparency, regulatory oversight of mining negotiations, strict enforcement of the legal framework and adherence to the fiscal regime is critical. Staff recommends:

- **Finalizing the Mining Act and strict enforcement of its provisions.** Mining is likely to become an important source of growth. Reaping benefits from the mining sector requires a strong regulatory and policy environment, enforcement of the fiscal regime and building capacity in contract negotiation and pricing of minerals. Work remains to be completed on

⁷ See “Strategy for Fintech Solutions in the Pacific”.

⁸ Solomon Islands is a signatory of the UN Convention Against Corruption, but the peer reviews of 2014 and 2018 identify gaps in the framework which need to be rectified.

⁹Reducing corruption is a key pillar and trigger under the World Bank’s 2019 Development Policy Operation for Solomon Islands.

legislation, regulation and oversight to create a conducive environment for mining. Gaps in agency coordination, tax administration and audit procedures also need to be addressed.

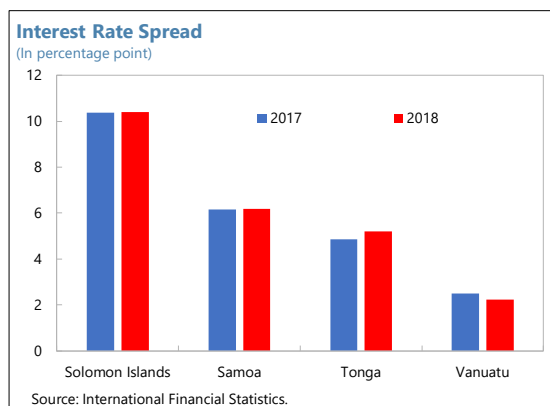
- **Action to eliminate revenue losses due to pricing practices.** Bauxite shipments are underpriced for fiscal purposes, implying significant losses on taxes and royalties. A recent IMF TA mission recommended an institutional setting and pricing framework for bauxite and other minerals to minimize these losses.
- **Reducing profit shifting risks from multinational enterprises.** There are information gaps on mining company group structures. The authorities should make sure that current permanent establishment provisions are adequate. The roles of different entities should be established at an early stage. Staff encourages the authorities to seek further technical support, including on contract negotiations and pricing.
- **Rejoining and implementing the Extractive Industries Transparency Initiative** and putting in place supporting legislation would promote greater accountability.
- **Swift implementation of the anti-corruption strategy.** This should include both prevention and enforcement and the establishment of an asset disclosure system (see Paragraph 39).

Authorities' Views

42. The authorities anticipate progress in the anti-corruption and legislative agenda over the next twelve months. While the anti-corruption bill has been passed, implementation has only just begun with the recent establishment of the secretariat in the Prime Minister's office. The secretariat will coordinate efforts of the anti-corruption institutions and ensure enforcement of corruption charges through the legal process. The authorities are appreciative of the recent IMF technical assistance on the fiscal aspects of bauxite pricing and would welcome assistance on wider fiscal issues facing the mining sector.

C. Financial Sector Development and Inclusion

43. Addressing exceptionally high interest rates on lending is a financial development challenge. Despite the relatively moderate NPLs and with the majority of personal sector bank loans being fully collateralized by deposits in the National Provident Fund, interest rates on personal loans remain as high as 17 percent and are high relative to rates prevailing across the region (see chart). Staff and the authorities agreed that controlling interest rate levels would not be a good solution. Instead, staff recommended that the CBSI maintain a market-based approach and gain a better understanding of banks' pricing structures and processes through discussions with



the banks on whether pricing reflects a risk-based approach, including whether banks are differentiating between secured and unsecured loans. The financial inclusion strategy, and bringing informal unregulated money lenders into the regulated sector, could also help increase credit supply.

44. Digital banking is propelling financial inclusion. The launch of the “youSave LoMobile” a service provided by the National Provident Fund in partnership with Solomon Telekom and Bmobile, will ease access to financial services in rural communities.¹⁰ Looking forward, the undersea cable is expected to accelerate financial inclusion through wider internet access. Staff welcomes plans to reset the financial inclusion strategy in 2020 to focus the agenda on climate resilience, as well as to revisit key goals that have not been achieved in the current strategy. Efforts to include financial literacy in the school curriculum should continue.

Authorities' Views

45. Wide-ranging measures are being implemented to foster financial inclusion. The CBSI has played a pivotal role in the launch of a National Provident Fund credit scheme linked to mobile savings and geared towards the informal sector. It enables mobile credit to be offset against a savings account tied to the NPF. The next financial inclusion strategy plan from 2020 will focus on green finance to build climate change resilience.

46. The authorities plan to discuss with banks the underlying drivers of high interest rate margins and will continue to pursue a market-based approach. The authorities are concerned that high interest rates constrain the supply of credit to households and small and medium-sized enterprises and are hampering private investment growth. The newly established Development Bank (DBSI) will cater to the rural agricultural sector and is small in scale.

OTHER ISSUES

47. Macroeconomic statistics should be given higher priority. The National Statistics Office has inadequate resources. Rebased GDP estimates are yet to be published. A business register and powers to require private-sector compliance with reporting would help improve data quality.

48. The authorities expressed interest in continued Fund technical assistance. The authorities expressed interest in TA to support the effective implementation of the anti-corruption Bill; a medium-term revenue strategy; PFM; and advice on transfer pricing in the mining sector. The CBSI would welcome advice with respect to the basket exchange rate peg. The national statistics office would appreciate additional peer learning, training, and technical assistance support.

¹⁰ YouSave LoMobile enables youSave members to deposit their mobile credit into a savings account tied to the National Provident Fund and check their youSave account balances at no cost using their mobile phones.

STAFF APPRAISAL

49. Economic activity has slowed and fiscal pressures are emerging. Weaker logging activity combined with halting of economic activity around the elections has slowed down growth. Headline inflation is contained and expected to remain subdued due to the moderation in economic activity. International reserves cover remains comfortable but is projected to decline over the medium term. However, the fiscal position is precarious, and the risks to the outlook are mostly on the downside. Fiscal discipline, strengthening governance, and a better policy and regulatory environment for businesses are essential to sustain growth.

50. Policy measures are needed to keep fiscal buffers above a minimum level. Rebuilding the government cash balance to a minimum of two months of total spending and prioritizing spending would help secure fiscal sustainability and build resilience. Efforts to recover tax arrears, and strengthen revenue administration and compliance have been successful and can help improve the fiscal position. Improving budget planning in line ministries, strengthening commitment controls and procurement planning, and prioritizing spending in line with the National Development Strategy would help safeguard fiscal sustainability. Once the cash balance is restored, the cash balance and debt limit should be supplemented by an operational fiscal target to guide annual budgets.

51. Pressing ahead with fiscal reforms will improve budget outcomes and the quality of spending. Public financial management reforms should continue. Greater transparency of the Constituency Development Funds is needed to demonstrate that this spending is in line with the National Development Strategy. Tax reforms offer an important opportunity to make the tax system more efficient, fair and equitable. A medium-term revenue strategy could help guide policy goals and sequencing.

52. Development-partner-financed infrastructure investments have to be managed carefully so they do not substantially add to fiscal risks and debt. Investment decisions and borrowing should be aligned with the development agenda. Spending on Pacific Games should be contained; financing needs to be transparent, follow procurement and PFM best practices, and be on grant or highly concessional terms, in line with debt sustainability and implementation capacity.

53. Excess liquidity in the banking system remains high. Addressing constraints on National Provident Fund investment abroad, stemming CBSI valuation losses, and tackling weak investor protection and uncertain property rights would reduce excess liquidity, enable collateralized lending, and improve monetary policy effectiveness.

54. The basket exchange rate peg is appropriate. The review on the composition of the basket is welcome. Managing the exchange rate in line with basket weights would lessen the erosion of competitiveness. The external sector position is assessed to be weaker than suggested by medium-term fundamentals. Fiscal consolidation and structural reforms would help to narrow the current account gap over the medium term.

55. Generating new sources of growth is becoming urgent with decline in logging. The new undersea internet cable could foster private sector development and public sector service delivery. Reaping benefits from improved connectivity requires appropriate investment in human capacity and physical infrastructure, as well as a sound regulatory framework and a sizable reduction in the cost of service provision. Structural reforms to improve the business environment would foster private sector development.

56. Progress in strengthening governance should continue. Anti-corruption measures should be strongly enforced. Work remains to be completed on legislation, regulation, and oversight to create a conducive environment for mining. It is critical that the governance problems which affected the logging sector do not spread to the mining sector.

57. The authorities should sustain financial sector reforms. Strengthening the AML/CMT framework should continue, to alleviate any future CBR risks. Enthusiasm about pursuing regional efforts to retain CBRs is laudable. A high priority should be given to finalizing the backlog of financial legislation. These acts fill gaps and would provide the basis for the CBSI to strengthen its supervisory framework. Efforts in expanding financial inclusion are commendable.

58. The quality of macroeconomic data could be further improved. Adequate resources should be channeled to work on the compilation and dissemination of economic data.

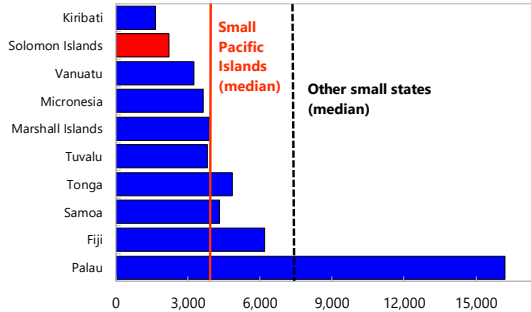
59. It is proposed that the next Article IV consultation takes place on the standard 12- month cycle.

Figure 1. Solomon Islands: The Cross-Country Context

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

GDP per Capita, 2018

(In U.S. dollars)

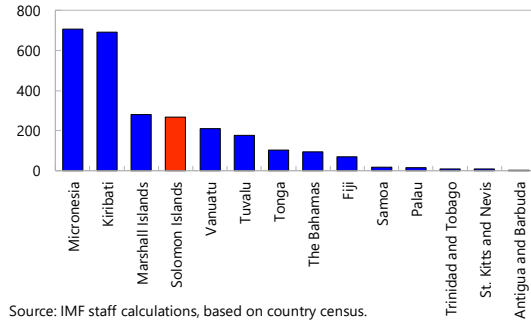


Sources: Country authorities and IMF staff calculations.

...geographical dispersion...

Geographical Dispersion: Average Sea Distance Between Two Inhabitants of the Same Country

(In kilometers)

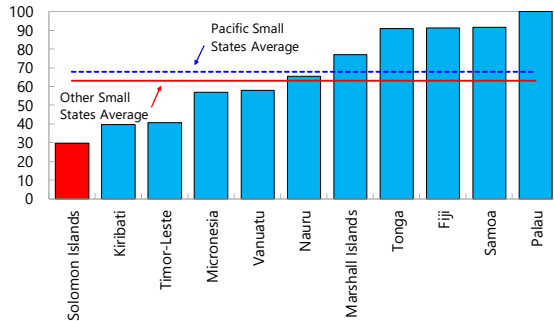


Source: IMF staff calculations, based on country census.

...low access to sanitation...

Sanitation Access, 2015

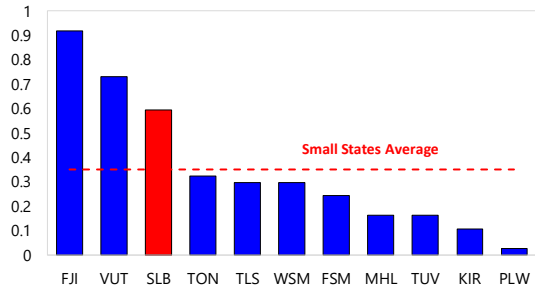
(In percent of population with access)



Sources: World Development Indicators.

...including vulnerability to natural disasters...

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

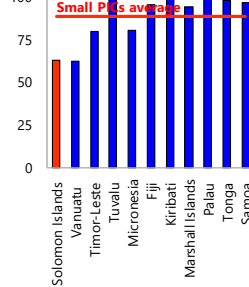


Sources: Center for Research on Epidemiology of Disasters, International Disaster Database; and IMF staff estimates.

...high infrastructure gaps...

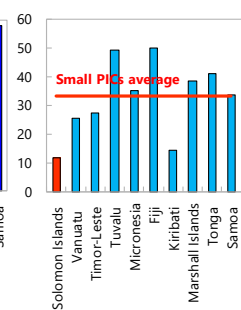
Access to Electricity

(In percent of population)



Internet Users

(In percent of population)

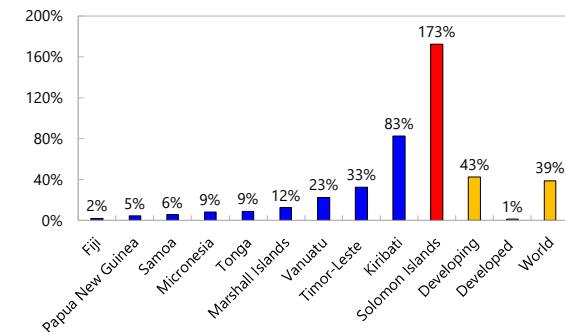


Source: World Bank Group, WDI.

...high broadband costs.

Fixed Broadband Basket

(In percent of GNI per capita)



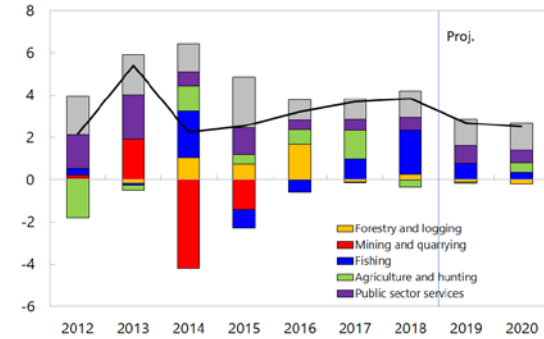
Source: International Telecommunication Union.

Figure 2. Solomon Islands: Macroeconomic Developments and Outlook

Growth was higher than expected in 2018 as logging driven by logging, but is expected to slow in 2019.

Sectoral Contributions to Real Growth

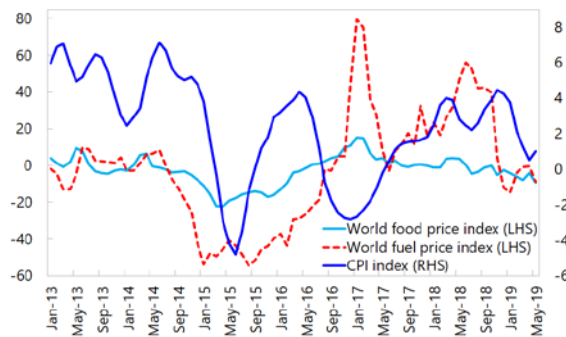
(In percentage points)



Commodity price inflation eased.

CPI Inflation and World Food/Fuel Price Index

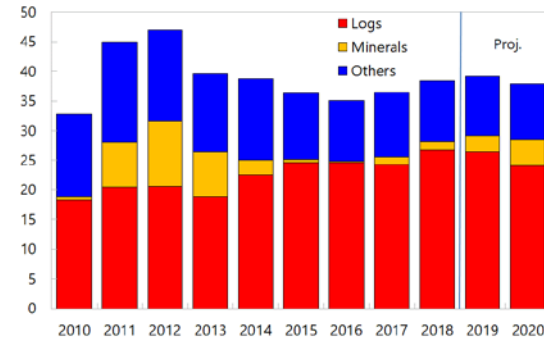
(Year-on-year percent change, 3 months moving average)



Logging exports have peaked....

Total Exports

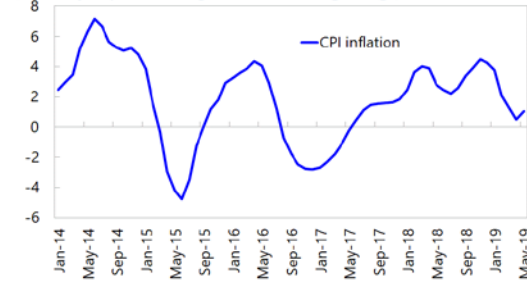
(In percent of GDP)



Inflation fell back in H1 2019.

CPI Inflation

(Year-on-year percent change, 3 months moving average)

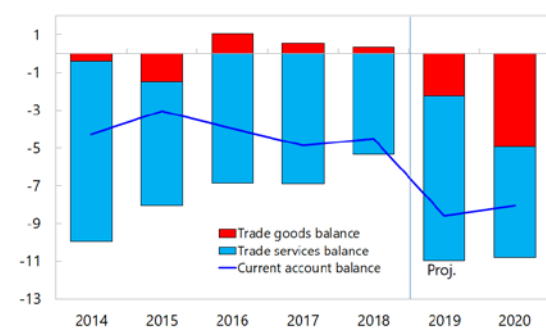


1/ A negative change means an appreciation of the Solomon Islands dollar against the Australian dollar.

The current account deficit is expected to widen with infrastructure projects picking up.

Current Account Balance

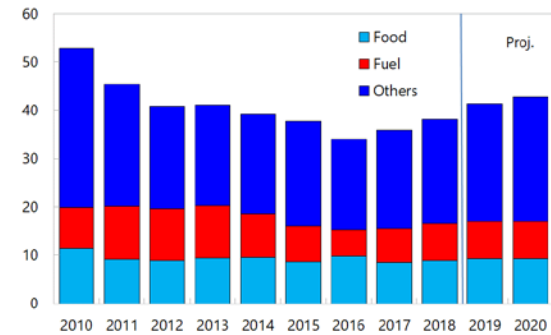
(In percent of GDP)



...but imports are increasing—again driven by infrastructure projects.

Total Imports

(In percent of GDP)



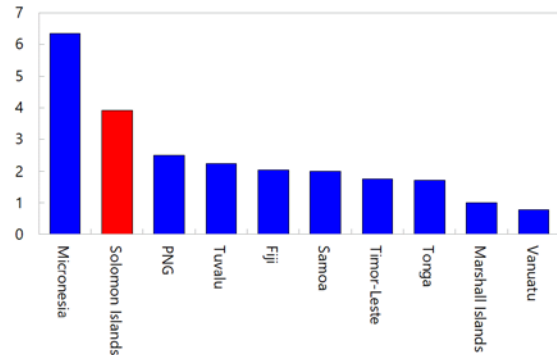
Sources: Country authorities and IMF staff estimates.

Figure 3. Solomon Islands: Fiscal indicators

Solomon Islands tax revenue is highly volatile...

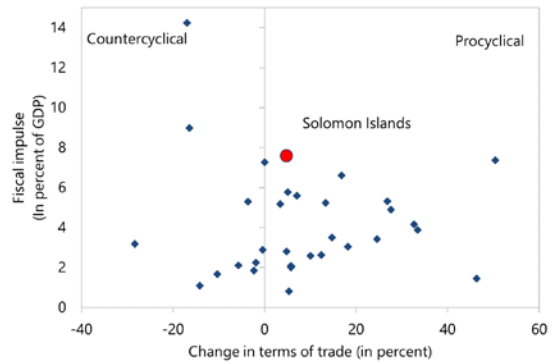
Volatility of Tax Revenue

(Standard deviation of tax revenue to GDP ratio, 2005-2018)



... and fiscal policy is procyclical due to weak PFM.

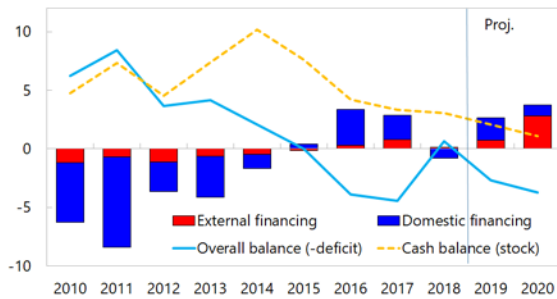
Fiscal Impulse and Terms of Trade, 2005-18



The cash balance temporarily improved in 2018 on unexpectedly strong revenue performance

Fiscal Balance and Financing

(In percent of GDP)

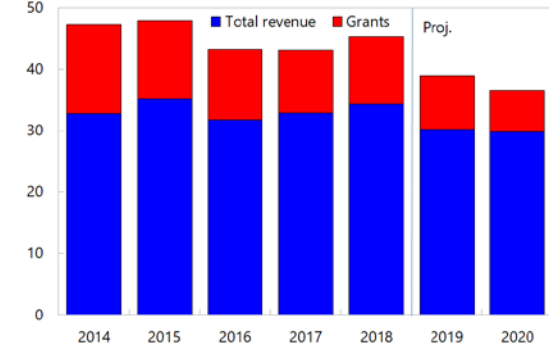


1/ Includes privatization receipts.

Revenues are likely to decline with declining logging exports...

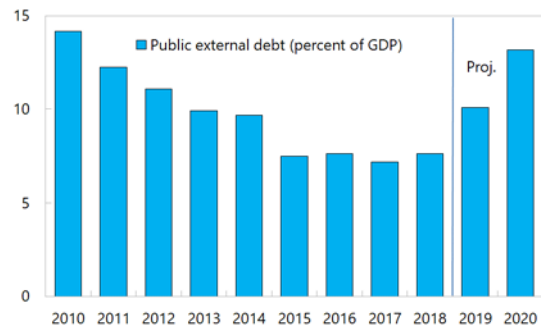
Government Revenue

(In percent of GDP)



... public debt is increasing from a low level to support infrastructure projects.

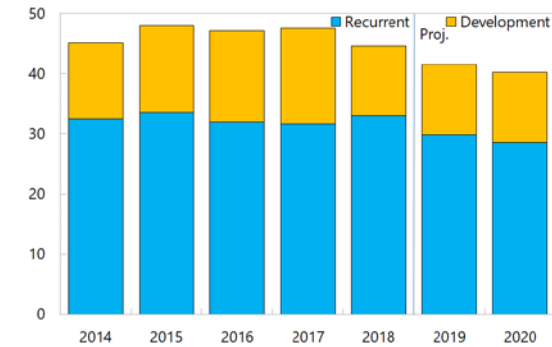
Public External Debt



...but expenditures are likely to remain high.

Government Expenditure

(In percent of GDP)

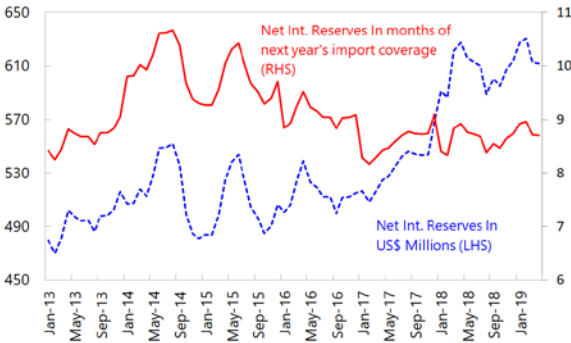


Sources: Country authorities and IMF staff estimates.

Figure 4. Solomon Islands: Money and Credit Developments

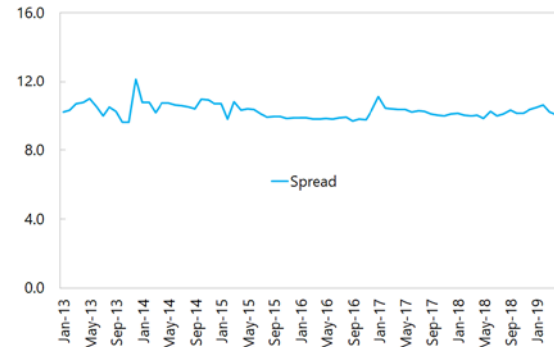
Reserves cover remains comfortable.

Net International Reserves
(In millions of US\$)



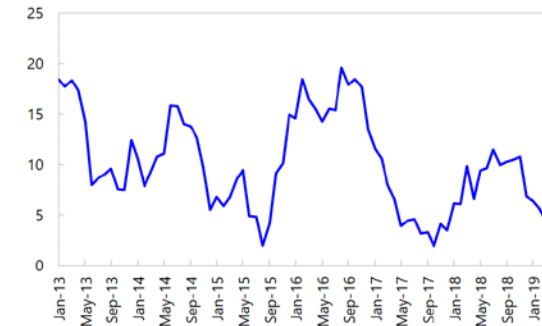
With an uncompetitive banking sector spreads remain very high.

Lending and Deposit Rates



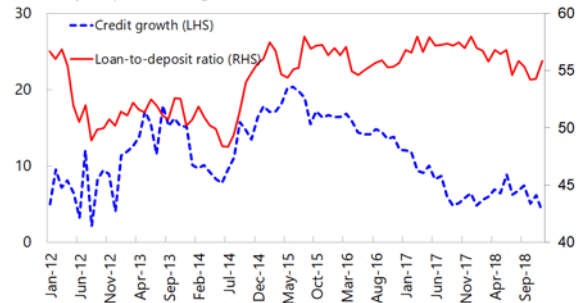
Broad money growth is relatively weak...

Broad Money
(Year-on-year percent change)



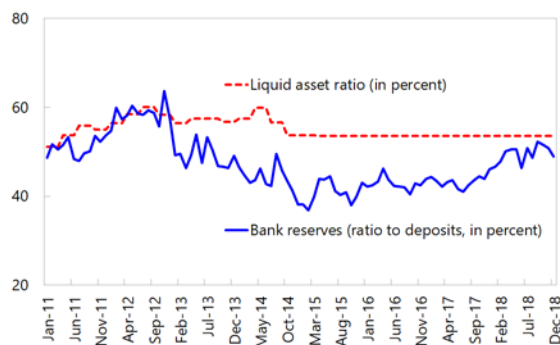
...and credit growth is modest as banks pulled back lending following high NPLs.

Credit Growth
(Year-on-year percent change)



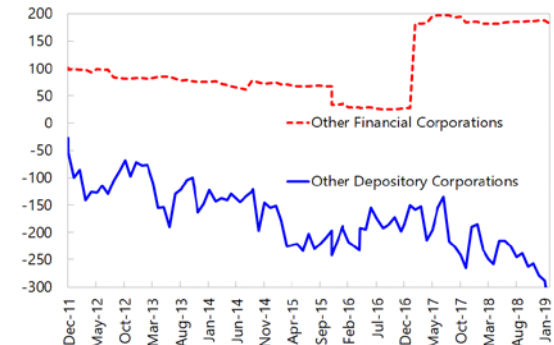
Bank excess reserves remain high.

Liquid Asset Ratio and Bank Reserves



Credit to central government has stabilized after bond issuance in 2017.

Net Credit to Central Government
(In millions of SIs)



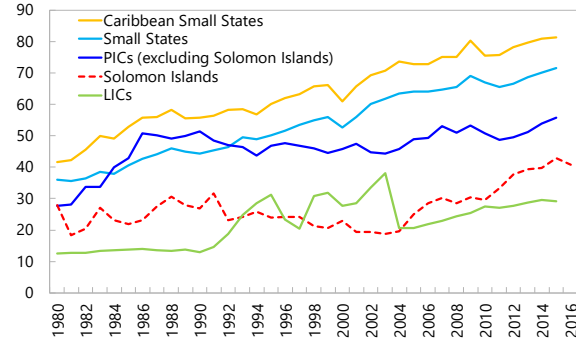
Sources: Central Bank of Solomon Islands and IMF staff estimates.

Figure 5. Solomon Islands: Financial Access and Inclusion

Financial depth is low in Solomon Islands...

Domestic Bank Deposits to GDP

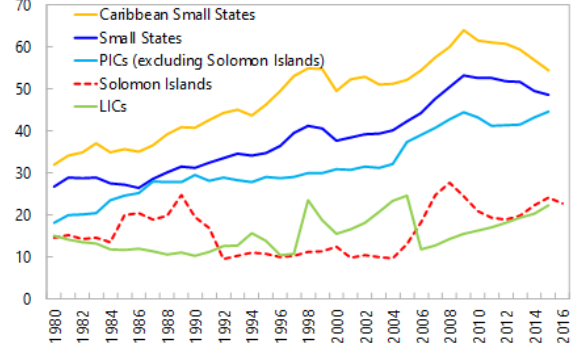
(In percent)



... access to credit remains lower than peers...

Private Credit to GDP

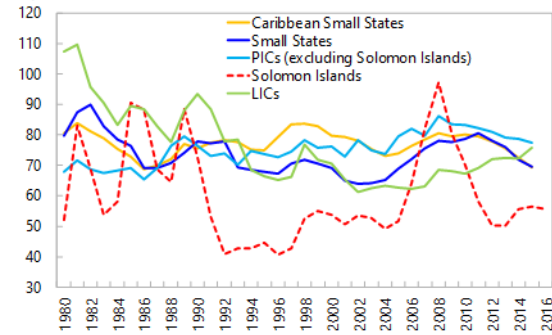
(In percent)



...and the loan to deposit ratio is very conservative

Private Credit to Deposits

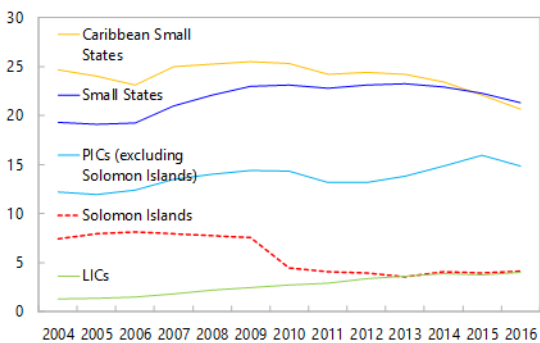
(In percent)



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

Number of Branches, Commercial Banks

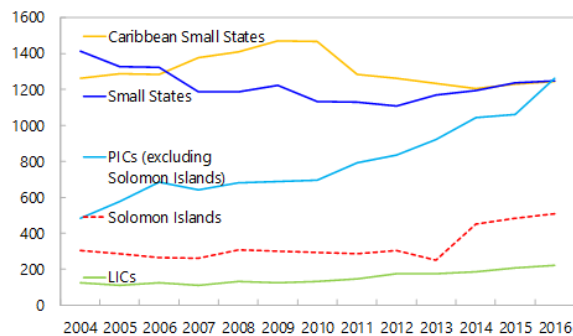
(Per 100,000 adults)



...resulting in relatively low access to commercial banks...

Accounts, Commercial Banks

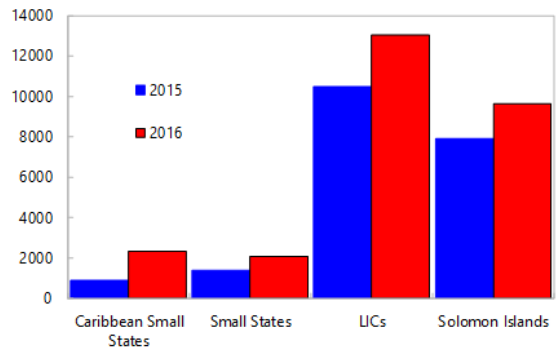
(Per 1,000 adults)



...although growth in mobile banking is a success story.

Number of Mobile Money Transactions

(Per 1,000 adults)

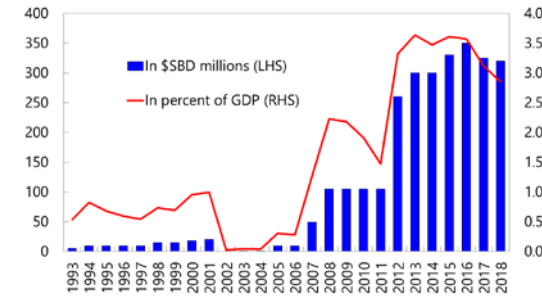


Sources: FomStats 2018 and Financial Access Survey.

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

CDF spending has increased over the past decade.

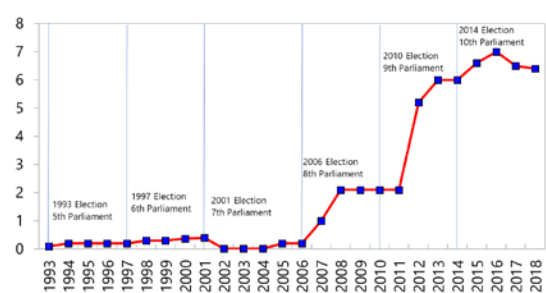
Solomon Islands Government (SIG) Budget Allocation For CDF



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

Amounts per constituency MP have risen sharply.

Budget Allocation Per Constituency
(In \$SBD millions)

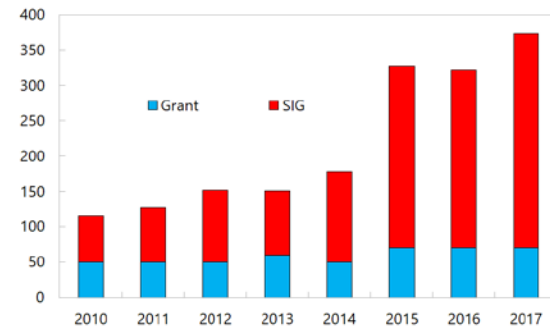


Sources: Fraenkel, J 2011, CDF Community Consultation and Assessment Workshop 2017, UNDEF.

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

CDF Actuals From 2010-2017

(In \$SBD millions)

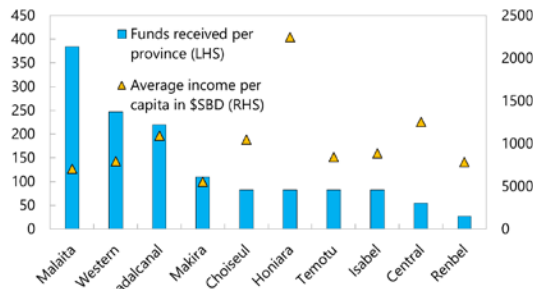


Source: Solomon Islands Authorities.

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

Funds Received Per Province From 2010-2017

(In \$SBD millions)

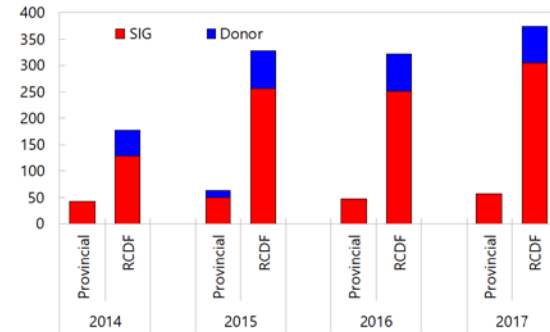


Sources: CDF Community Consultation and Assessment Workshop 2017, UNDEF, Solomon Islands HIES 2012/13.

CDF spending is substantially higher than provincial allocations.

Spending on Provincial Government and CDF

(In \$SBD millions)

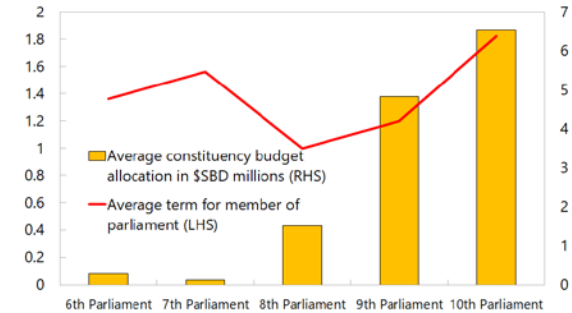


Source: Solomon Islands Authorities.

Average tenure of MPs has risen over time.

Average Term of Parliament Members 1/

(In unit)



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

Table 1. Solomon Islands: Selected Economic Indicators, 2015-24

Per capita GDP (2017): US\$2,144
Population (2017): 613,712

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
					Proj.	Proj.				
GROWTH AND PRICES										
	Annual percentage change unless otherwise indicated									
Real GDP	2.5	3.2	3.7	3.9	2.7	2.5	2.7	2.8	2.8	2.9
CPI (period average)	-0.6	0.5	0.5	3.5	1.9	2.3	2.9	3.5	3.7	4.0
CPI (end of period)	3.5	-2.2	2.1	3.9	2.2	2.4	3.3	3.5	3.9	4.0
GDP deflator	3.1	3.7	1.9	3.5	1.4	2.4	3.0	3.4	3.7	4.0
Nominal GDP (in SI\$ millions)	9,139	9,780	10,330	11,099	11,553	12,130	12,839	13,643	14,544	15,556
CENTRAL GOVERNMENT OPERATIONS										
	In percent of GDP									
Total revenue and grants	47.9	43.2	43.1	45.3	39.0	36.5	36.7	37.2	38.3	37.3
Revenue	35.1	31.8	32.8	34.3	30.1	29.8	29.6	29.5	29.2	29.1
Grants	12.9	11.4	10.2	11.0	8.8	6.7	7.2	7.7	9.1	8.2
Total expenditure	48.0	47.1	47.5	44.6	41.6	40.2	41.6	42.2	43.9	42.1
excluding grant-funded expenditure	35.1	35.7	37.3	33.6	32.8	33.5	34.4	34.4	34.8	33.9
Recurrent expenditure	33.7	32.1	31.8	33.0	29.8	28.6	28.7	28.9	29.0	29.1
Development expenditure	14.3	15.0	15.8	11.6	11.8	11.7	12.9	13.3	14.9	13.0
Unrecorded expenditure 1/	0.2	-0.6	-1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	0.0	-3.9	-4.5	0.7	-2.7	-3.7	-4.8	-5.0	-5.6	-4.8
Foreign financing (net)	-0.2	0.3	0.8	0.2	0.8	2.8	3.6	3.5	3.7	2.7
Domestic financing (net)	0.4	3.0	2.1	-0.8	1.9	0.9	1.2	1.5	1.8	2.1
Central government debt 1/	7.9	9.5	9.4	11.6	14.9	18.9	22.8	26.9	30.0	33.1
MACROFINANCIAL										
	Annual percentage change (end of year)									
Credit to private sector	16.7	12.1	6.4	4.1	4.9	5.5	5.7	6.0	5.0	4.5
Broad money	15.0	13.4	3.5	6.8	2.1	2.4	5.1	4.1	2.6	3.3
Reserve money	23.5	14.5	7.5	10.5	0.0	4.8	6.9	2.2	2.6	1.5
BALANCE OF PAYMENTS										
	In US\$ millions unless otherwise indicated									
Trade balance	-93.5	-71.7	-81.7	-69.4	-156.0	-161.6	-219.9	-280.4	-335.8	-306.3
(percent of GDP)	-8.1	-5.8	-6.4	-5.0	-11.0	-10.8	-13.9	-16.7	-18.8	-16.0
Current account balance	-35.3	-48.8	-62.8	-62.5	-121.9	-120.2	-168.4	-219.1	-264.2	-233.6
(percent of GDP)	-3.0	-4.0	-4.9	-4.5	-8.6	-8.1	-10.7	-13.1	-14.8	-12.2
Foreign direct investment	27.6	36.0	50.0	43.1	48.5	53.4	61.4	65.9	68.1	72.4
(percent of GDP)	2.4	2.9	3.9	3.1	3.4	3.6	3.9	3.9	3.8	3.8
Overall balance	5.3	-5.9	63.2	36.2	-9.5	-0.5	-4.8	-32.3	-38.0	-27.5
Gross official reserves (in US\$ millions, end of period) 2/	519.6	513.6	576.9	613.1	601.5	600.8	595.7	563.1	525.1	497.6
(in months of next year's imports of GNFS)	10.0	9.1	9.3	8.5	8.1	7.6	7.0	6.2	5.4	5.2
Net official reserves (in US\$ millions, end of period)	505.6	503.5	566.7	603.0	593.5	593.0	588.2	556.0	518.0	490.5
(in months of next year's imports of GNFS)	9.7	8.9	9.1	8.4	8.0	7.5	6.9	6.1	5.3	5.1
EXCHANGE RATE (SI\$/US\$, end of period)										
Real effective exchange rate (end of period, 2010 = 100)	127.3	127.8	126.3	130.8	...	...	...	...	...	...
MEMORANDUM ITEMS:										
Cash balance (in SI\$ millions)	694	412	343	337	240	129	-26	-238	-512	-846
in months of recurrent spending	3.6	2.0	1.5	1.3	0.9	0.5	-0.1	-0.8	-1.6	-2.5
SIG Deposit Account (In addition to cash balance, in SI\$ millions)	140	140	140	140	140	140	140	141	142	143
Broader cash balance (=Cash balance+ SIG Deposit Account; in SI\$ millions)	834	552	483	477	380	269	114	-97	-370	-703
in months of total spending 3/	3.1	1.9	1.5	2.1	1.4	1.0	0.5	-0.1	-0.7	-1.5
Public domestic debt, including arrears (in SI\$ millions)	43	43	193	245	502	613	768	966	1,219	1,533

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

1/ Includes disbursements under the IMF-supported programs.

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

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

Table 2a. Solomon Islands: Summary of Fiscal Accounts, 2016-24
(In millions of Solomon Islands Dollars)

	2016	2017	2018	2019		2020		2021	2022	2023	2024	
	Act.	Act.	Act.	Original Budget	Revised Estimates	Proj.	Original Budget	Proj.	Proj.	Proj.	Proj.	
Total revenue and grants	4,226	4,449	5,026	4,662	4,262	4,500	4,541	4,427	4,718	5,077	5,577	5,797
Total revenue	3,108	3,391	3,809	3,643	3,449	3,481	3,484	3,614	3,800	4,020	4,252	4,525
Tax revenue	2,578	2,838	3,272	3,109	2,935	2,950	2,932	3,056	3,209	3,393	3,583	3,809
Income and profits	947	1,028	1,093	1,145	1,105	1,109	1,066	1,119	1,178	1,296	1,388	1,499
Goods and services	833	939	1,091	1,099	1,021	992	1,102	1,038	1,094	1,158	1,239	1,339
International trade and transactions	798	871	1,088	865	808	848	765	900	937	939	956	971
Of which: Tax on logging	579	629	790	558	541	581	475	580	599	570	558	552
Other revenue	530	552	537	534	514	532	552	558	590	627	669	716
Grants	1,118	1,058	1,217	1,019	813	1,019	1,057	813	919	1,057	1,325	1,272
Development grants	423	471	586	724	504	724	713	504	593	713	960	884
Recurrent budget grants	695	587	631	296	309	296	344	309	325	344	365	388
Expenditure	4,609	4,910	4,951	4,754	4,521	4,810	4,508	4,881	5,340	5,755	6,385	6,542
Of which: excluding grant-funded expenditure	3,491	3,852	3,734	3,735	3,709	3,790	3,451	4,068	4,421	4,697	5,060	5,269
Recurrent expenditure	3,137	3,280	3,668	3,410	3,156	3,441	3,229	3,466	3,685	3,939	4,213	4,526
Of which: excluding grant-funded expenditure	2,442	2,693	3,037	3,115	2,861	3,145	2,920	3,157	3,360	3,595	3,849	4,138
Compensation of employees	1,009	1,063	1,169	1,243	1,242	1,206	1,292	1,266	1,340	1,424	1,518	1,624
Interest payments	9	15	27	22	22	21	22	19	44	60	79	103
Other recurrent expenditure	2,120	2,202	2,334	2,126	1,892	2,134	1,915	2,181	2,300	2,454	2,616	2,799
Government funded	1,425	1,615	1,703	1,830	1,596	1,839	1,606	1,872	1,975	2,111	2,252	2,410
Grant-funded	695	587	631	296	296	296	309	309	325	344	365	388
Contingency Warrant Provision				19								
Resolution of domestic arrears			138			80						
Development expenditure	1,472	1,630	1,284	1,344	1,365	1,369	1,279	1,415	1,655	1,816	2,172	2,016
Government funded development expenditure	1,049	1,159	697	620	861	645	775	911	1,061	1,102	1,212	1,132
Domestic	944	1,007	626	475	475	500	389	525	552	587	625	669
External loan	104	152	72	145	386	145	386	386	509	516	586	463
Grant funded	423	471	586	724	504	724	504	504	593	713	960	884
Of which: CDFs	322	374	380	120	120	220	120	315	333	353	375	399
Discrepancy 1/	-56	-163	0	0	0	0	0	0	0	0	0	0
Current balance 2/	666	698	772	528	588	336	564	457	440	425	403	387
Primary balance	-215	-446	102	-70	2	-289	-189	-435	-577	-618	-730	-641
Overall balance	-383	-461	74	-92	-260	-309	33	-453	-622	-678	-808	-745
Total financing	383	461	-74	92	260	309	-33	453	622	678	808	745
Foreign (net)	31	79	17	92	16	87	86	342	466	473	545	421
Domestic (net)	352	219	-91	0	244	222	-120	111	155	205	263	324
Of which : Change in cash balance (+ = decrease)	282	69	6	0	103	96	111	111	155	212	274	335
Change in public domestic debt (+ = increase)	43	150	53	0	23	257	257	111	155	198	253	314
Banking system	304	69	-121	-10	257	136	125	111	155	-7	-10	-10
Central bank	260	69	-144	0	219	96	126	111	155	0	0	0
Commercial banks	44	0	23	-10	39	40	-1	0	0	-7	-10	-10
Nonbank (National Provident Fund and SOEs)	-8	150	30	0	0	86	0	0	0	0	0	0
Memorandum items:												
Nominal GDP (in SI\$ millions)	9,780	10,330	11,099	11,553	11,553	11,553	12,130	12,130	12,839	13,643	14,544	15,556
Public domestic debt, including arrears (in SI\$ millions)	43	193	245	502	245	502	502	613	768	966	1,219	1,533
Narrow cash balance (in SI\$ millions) 3/	412	343	337	240	240	240	129	129	-26	-238	-512	-846
in months of recurrent spending 4/	2.0	1.5	1.3	0.9	1.0	0.9	0.5	0.5	-0.1	-0.8	-1.6	-2.5
SIG Deposit Account (in SI\$ millions)	140	140	140	140	140	140	139	140	140	140	140	140
Broader cash balance (in SI\$ millions)	552	483	477	380	380	380	268	269	114	-98	-372	-706
in months of total spending 5/	1.9	1.5	1.5	1.2	1.2	1.2	0.9	0.8	0.3	-0.3	-0.9	-1.6
Accumulated domestic arrears (in SI\$ million)		138	80	0	0	0	0	0	0	0	0	0
Non-commodity primary balance 6/ (in SI\$ millions)	-953	-1,075	-688	-628	-779	-870	-419	-1,015	-1,176	-1,197	-1,303	-1,230

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

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

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

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

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

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

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

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

Table 2b. Solomon Islands: Summary of Fiscal Accounts, 2016-24
(in percent of GDP)

	2016	2017	2018	2019			2020	2021	2022	2023	2024	
	Act.	Act.	Act.	Original Budget	Revised Estimates	Proj.	Original Budget	Proj.	Proj.	Proj.	Proj.	
Total revenue and grants	43.2	43.1	45.3	40.4	36.8	39.0	37.2	36.5	36.7	37.2	38.3	37.3
Total revenue	31.8	32.8	34.3	31.5	29.9	30.1	28.7	29.8	29.6	29.5	29.2	29.1
Tax revenue	26.4	27.5	29.5	26.9	25.4	25.5	24.2	25.2	25.0	24.9	24.6	24.5
Income and profits	9.7	10.0	9.8	9.9	9.6	9.6	8.8	9.2	9.2	9.5	9.5	9.6
Goods and services	8.5	9.1	9.8	9.5	8.8	8.6	9.1	8.6	8.5	8.5	8.5	8.6
International trade and transactions	8.2	8.4	9.8	7.5	7.0	7.3	6.3	7.4	7.3	6.9	6.6	6.2
Of which: Tax on logging	5.9	6.1	7.1	4.8	4.7	5.0	3.9	4.8	4.7	4.2	3.8	3.6
Other revenue	5.4	5.3	4.8	4.6	4.4	4.6	4.5	4.6	4.6	4.6	4.6	4.6
Grants	11.4	10.2	11.0	8.8	6.9	8.8	8.4	6.7	7.2	7.7	9.1	8.2
Development grants	4.3	4.6	5.3	6.3	4.4	6.3	5.9	4.2	4.6	5.2	6.6	5.7
Recurrent budget grants	7.1	5.7	5.7	2.6	2.6	2.6	2.5	2.5	2.5	2.5	2.5	2.5
Expenditure	47.1	47.5	44.6	41.2	39.1	41.6	37.2	40.2	41.6	42.2	43.9	42.1
Of which: excluding grant-funded expenditure	35.7	37.3	33.6	32.3	32.2	32.8	28.7	33.5	34.4	34.4	34.8	33.9
Recurrent expenditure	32.1	31.8	33.0	29.5	27.3	29.8	26.6	28.6	28.7	28.9	29.0	29.1
Of which: excluding grant-funded expenditure	25.0	26.1	27.4	27.0	24.8	27.2	24.1	26.0	26.2	26.3	26.5	26.6
Compensation of employees	10.3	10.3	10.5	10.8	10.8	10.4	10.6	10.4	10.4	10.4	10.4	10.4
Interest payments	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.4	0.5	0.7
Other recurrent expenditure	21.7	21.3	21.0	18.4	16.4	18.5	15.8	18.0	17.9	18.0	18.0	18.0
Government funded	14.6	15.6	15.3	15.8	13.8	15.9	13.2	15.4	15.4	15.5	15.5	15.5
Grant funded	7.1	5.7	5.7	2.6	2.6	2.6	2.5	2.5	2.5	2.5	2.5	2.5
Contingency Warrant Provision				0.2	0.0							
Resolution of domestic arrears			1.2									
Development expenditure	15.0	15.8	11.6	11.6	11.8	11.8	10.5	11.7	12.9	13.3	14.9	13.0
Government funded	10.7	11.2	6.3	5.4	7.5	5.6	6.4	7.5	8.3	8.1	8.3	7.3
Domestic	9.7	9.7	5.6	4.1	4.1	4.3	3.2	4.3	4.3	4.3	4.3	4.3
External loan	1.1	1.5	0.6	1.3	3.3	1.3	3.2	3.2	4.0	3.8	4.0	3.0
Grant funded	4.3	4.6	5.3	6.3	4.4	6.3	4.2	4.2	4.6	5.2	6.6	5.7
Of which: CDFs	3.3	3.6	3.4	1.0	1.0	1.9	1.0	2.6	2.6	2.6	2.6	2.6
Discrepancy 1/	-0.6	-1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current balance 2/	6.8	6.8	7.0	4.6	5.1	2.9	4.6	3.8	3.4	3.1	2.8	2.5
Primary balance	-2.2	-4.3	0.9	-0.6	0.0	-2.5	-1.6	-3.6	-4.5	-4.5	-5.0	-4.1
Overall balance	-3.9	-4.5	0.7	-0.8	-2.4	-2.7	0.0	-3.7	-4.8	-5.0	-5.6	-4.8
Total financing	3.9	4.5	-0.7	0.8	2.4	2.7	0.0	3.7	4.8	5.0	5.6	4.8
Foreign (net)	0.3	0.8	0.2	0.8	0.1	0.8	0.7	2.8	3.6	3.5	3.7	2.7
Disbursements	1.1	1.5	0.6	1.3	0.6	1.3	1.2	3.2	4.0	3.8	4.0	3.0
Amortization (accrual)	-0.7	-0.7	-0.5	-0.5	-0.5	-0.5	-0.5	-0.4	-0.3	-0.3	-0.3	-0.3
Domestic (net)	3.6	2.1	-0.8	0.0	2.2	1.9	-0.7	0.9	1.2	1.5	1.8	2.1
Of which: Change in cash balance (+ = decrease)	2.9	0.7	0.1	0.0	0.9	0.8						
Change in public domestic debt (+ = increase)	0.4	1.5	0.5	0.0	0.2	2.2	2.1	0.9	1.2	1.4	1.7	2.0
Banking system	3.1	0.7	-1.1	-0.1	2.2	1.2	1.0	0.9	1.2	-0.1	-0.1	-0.1
Central bank	2.7	0.7	-1.3	0.0	1.9	0.8	1.0	0.9	1.2	0.0	0.0	0.0
Commercial banks	0.5	0.0	0.2	-0.1	0.3	0.3	0.0	0.0	0.0	-0.1	-0.1	-0.1
Nonbank (National Provident Fund and SOEs)	-0.1	1.5	0.3	0.0	0.0	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:												
Accumulated domestic arrears (In percent of GDP)		1.3	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public domestic debt, including arrears (In percent of GDP)	0.4	1.9	2.2	4.3	2.1	4.3	4.1	5.1	6.0	7.1	8.4	9.9
Non-commodity primary balance (In percent of GDP) 3/	-9.7	-10.4	-6.2	-5.4	-6.9	-7.5	-3.7	-8.4	-9.2	-8.8	-9.0	-7.9

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

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

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

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

Table 3. Solomon Islands: Balance of Payments, 2015–24¹

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
					Est.	Proj.				
	(In millions of U.S. dollars)									
Current account balance	-35.3	-48.8	-62.8	-62.5	-121.9	-120.2	-168.4	-219.1	-264.2	-233.6
Trade balance for goods	-17.2	12.8	7.2	4.7	-31.9	-73.5	-125.4	-179.0	-226.9	-189.6
Exports	420.3	432.1	469.3	534.1	556.1	565.7	562.4	565.4	578.8	669.3
Imports	-437.5	-419.4	-462.1	-529.4	-588.0	-639.2	-687.8	-744.4	-805.7	-858.9
Trade balance for services	-76.4	-84.5	-88.9	-74.0	-124.0	-88.1	-94.5	-101.4	-108.8	-116.8
Exports	106.3	122.6	128.9	144.6	152.0	159.2	166.8	174.5	182.8	191.6
Imports	-182.7	-207.2	-217.8	-218.7	-276.0	-247.3	-261.2	-275.9	-291.6	-308.4
Income balance	-24.2	-41.6	-33.3	-30.0	-28.4	-29.2	-28.1	-27.8	-27.7	-37.2
Current transfers balance	82.4	64.5	52.2	36.8	62.5	70.7	79.6	89.1	99.2	110.0
Of which: Official transfers, net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital and financial account balance	88.6	93.4	126.6	116.4	132.5	139.7	183.6	206.8	246.3	226.1
Capital account balance	55.2	53.3	59.6	60.0	89.0	62.0	73.0	87.8	118.1	108.8
Direct investment balance	27.6	36.0	50.0	43.1	48.5	53.4	61.4	65.9	68.1	72.4
Portfolio investment balance	-0.7	-1.7	2.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Other investment balance	6.5	5.8	15.0	13.4	-5.1	24.3	49.3	53.1	60.1	44.9
Assets	16.2	-7.5	4.8	6.0	-9.1	-7.3	-7.6	-7.5	-7.3	-7.2
of which, amortization of official loans	11.9	-4.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Liabilities	-9.7	13.3	10.2	7.5	4.0	31.6	56.9	60.7	67.3	52.1
of which, disbursement of official loans (incl. SDR)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-58.6	-38.7	-127.0	-90.1	-20.0	-20.0	-20.0	-20.0	-20.0	-20.0
Overall balance	5.3	-5.9	63.2	36.2	-9.5	-0.5	-4.8	-32.3	-38.0	-27.5
Financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in gross reserves (- = increase)	-5.3	5.9	-63.2	-36.2	9.5	0.5	4.8	32.3	38.0	27.5
IMF	5.3	-5.9	63.2	36.2	-9.5	-0.5	-4.8	-32.3	-38.0	-27.5
	(In percent of GDP, unless otherwise indicated)									
Current account	-3.0	-4.0	-4.9	-4.5	-8.6	-8.1	-10.7	-13.1	-14.8	-12.2
Trade balance for goods	-1.5	1.0	0.6	0.3	-2.2	-4.9	-7.9	-10.7	-12.7	-9.9
Exports	36.3	35.1	36.5	38.5	39.1	37.9	35.6	33.7	32.4	35.0
Imports	37.8	34.0	35.9	38.1	41.4	42.8	43.6	44.4	45.0	44.9
Of which: Official transfers net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital account balance	4.8	4.3	4.6	4.3	6.3	4.2	4.6	5.2	6.6	5.7
Direct investment balance	2.4	2.9	3.9	3.1	3.4	3.6	3.9	3.9	3.8	3.8
Of which: Inward FDI ^{2/}	2.8	3.0	3.3	2.5	3.4	3.5	3.8	3.9	3.8	3.8
Other investment balance	0.6	0.5	1.2	1.0	-0.4	1.6	3.1	3.2	3.4	2.3
Memorandum items										
Net international reserves (in US\$ million)	506	503	567	603	593	593	588	556	518	491
In months of next year's GNFS	9.7	8.9	9.1	8.4	8.0	7.5	6.9	6.1	5.3	5.1
Gross official foreign reserves (in US\$ million) ^{3/}	520	514	577	613	601	601	596	563	525	498
In months of next year's imports of GNFS	10.0	9.1	9.3	8.5	8.1	7.6	7.0	6.2	5.4	5.2
Gross external public debt	7.5	7.6	7.1	7.6	10.1	13.2	15.9	18.6	20.1	21.7
Disbursement of concessional borrowing (in US\$ millions)	0.2	23.5	17.9	9.0	17.8	42.2	40.4	47.3	72.5	53.0
External public debt service (in percent of exports of GNFS)	1.5	1.8	1.7	1.1	1.1	0.6	0.9	1.0	1.0	1.0

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

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

Table 4. Solomon Islands: Summary Accounts of the Banking System, 2015–24¹

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
	Proj.									
(In millions of Solomon Islands dollars, end of period)										
Central Bank of Solomon Islands (CBSI)										
Net foreign assets (NFA)	3,960	4,018	4,366	4,834	4,740	4,734	4,693	4,428	4,119	3,895
Net international reserves (NIR)	4,077	4,127	4,481	4,957	4,863	4,857	4,816	4,551	4,242	4,018
Other NFA	-117	-109	-115	-123	-123	-123	-123	-123	-123	-123
Net domestic assets (NDA)	-1,698	-1,429	-1,583	-1,758	-1,664	-1,511	-1,246	-904	-505	-226
Net claims on central government	-1,110	-850	-963	-1,026	-930	-819	-664	-452	-178	157
Claims	5	5	5	5	5	5	5	5	5	5
Deposits	1,115	855	968	1,032	935	824	669	457	183	-151
Other items (net)	149	134	143	136	136	136	136	136	136	136
Reserve money	2,262	2,589	2,783	3,076	3,077	3,223	3,447	3,524	3,614	3,670
Currency in circulation	740	828	896	908	945	992	1,050	1,116	1,189	1,272
Bank deposits	1,511	1,748	1,875	2,158	2,121	2,220	2,385	2,395	2,411	2,383
Other deposits	11	13	12	10	11	11	12	13	14	15
Other depository corporations										
NFA of commercial banks	169	155	217	218	249	256	263	270	278	285
Assets	281	305	323	439	470	477	484	492	499	507
Liabilities	112	150	106	221	221	221	221	221	221	221
NDA of commercial banks	1,750	1,999	1,909	1,950	2,028	2,000	2,046	2,196	2,252	2,394
Net claims on central government	-243	-198	-265	-257	-217	-217	-217	-224	-235	-245
Claims	15	19	17	25	65	65	65	57	47	37
Deposits	257	217	282	282	282	282	282	282	282	282
Claims on the private sector	1,981	2,221	2,363	2,460	2,583	2,725	2,882	3,054	3,207	3,351
Other items (net)	12	-24	-190	-253	-338	-507	-618	-634	-720	-713
Reserves and vault cash	1,596	1,834	1,950	2,238	2,200	2,303	2,509	2,528	2,552	2,534
Deposits	3,515	3,988	4,076	4,406	4,477	4,559	4,819	4,995	5,082	5,213
Depository corporations survey										
NFA of the banking system	4,129	4,173	4,583	5,053	4,989	4,990	4,956	4,698	4,397	4,181
Central bank	3,960	4,018	4,366	4,834	4,740	4,734	4,693	4,428	4,119	3,895
Other depository corporations	169	155	217	218	249	256	263	270	278	285
NDA of the banking system	52	570	326	192	364	489	800	1,293	1,747	2,168
Net claims on central government	-1,352	-1,048	-1,228	-1,283	-1,147	-1,036	-881	-676	-413	-89
Claims on the private sector 2/	1,988	2,229	2,372	2,469	2,590	2,732	2,889	3,061	3,214	3,358
Other items (net)	-584	-611	-818	-994	-1,079	-1,206	-1,207	-1,093	-1,054	-1,102
Broad money (M3)	4,181	4,743	4,909	5,244	5,353	5,479	5,756	5,991	6,144	6,349
M1	3,272	3,521	3,649	3,937	4,086	4,247	4,526	4,775	4,959	5,124
Currency outside banks	655	742	821	828	866	909	925	983	1,048	1,121
Demand deposits	2,617	2,779	2,828	3,109	3,220	3,338	3,601	3,791	3,911	4,003
Savings and time deposits	908	1,221	1,260	1,307	1,268	1,233	1,230	1,216	1,185	1,224
(Annual percentage change, unless otherwise indicated)										
Reserve money	23.5	14.5	7.5	10.5	0.0	4.8	6.9	2.2	2.6	1.5
Credit to the private sector	16.7	12.1	6.4	4.1	5.0	5.5	5.8	6.0	5.0	4.5
Broad money	15.0	13.4	3.5	6.8	2.1	2.4	5.1	4.1	2.6	3.3
Memorandum items:										
Money multiplier (level)	1.8	1.8	1.8	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Loan-to-deposit ratio (in percent)	56.4	55.7	58.0	55.8	57.7	59.8	59.8	61.2	63.1	64.3
Interest rates (percent per annum)										
Deposit rate 3/	0.3	0.3	...	...	...	...	...	...	...	...
Lending rate 3/	10.5	10.1	...	...	...	...	...	...	...	...
NCG of financial corporations	-1,319	-1,022	-1,044	-1,097	-875	-764	-609	-404	-140	184
91-day treasury bill rate	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: Core Financial Soundness Indicators, 2014-18
(In percent)

	2014	2015	2016	2017	2018
Capital Adequacy					
Regulatory Capital to Risk-Weighted Assets	31.6	31.1	32.5	35.1	31.1
Non-performing Loans Net of Provisions to Capital	8.1	7.3	6.6	11.5	11.8
Asset Quality					
Non-performing Loans to Total Gross Loans	4.7	4.1	3.8	6.1	7.1
Specific Loan Loss Provision to NPLs	26.0	29.5	31.2	18.7	31.2
Earnings and Profitability					
Return on Assets	3.3	3.0	3.5	3.9	3.5
Return on Equity	20.0	17.6	22.7	23.1	20.4
Interest Margin to Gross Income	56.7	55.0	56.3	55.0	54.6
Non-interest Expenses to Gross Income	43.3	45.0	43.7	45.0	45.4
Liquidity					
Liquid Assets to Total Assets (Liquid Asset Ratio)	38.0	33.5	38.1	38.4	40.4
Liquid Assets to Short Term Liabilities	51.7	46.2	53.3	55.4	56.2
Net open position in foreign exchange to capital	11.1	7.9	3.6	3.8	13.1
Source: Central Bank of Solomon Islands.					

Table 6. Solomon Islands: Indicators of Capacity to Repay the Fund, 2018–27

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
	Proj.									
Fund obligations based on existing credit (in SDR millions)										
Principal	2.4	0.03	0.13	0.18	0.21	0.16	0.13	0.07	0.03	0.00
Charges and interest	0.08	0.00	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07
In millions of SDRs	2.48	0.03	0.20	0.25	0.28	0.23	0.20	0.14	0.10	0.07
In millions of US\$	3.49	0.04	0.28	0.35	0.39	0.32	0.28	0.20	0.14	0.10
In percent of gross international reserves	0.57	0.01	0.05	0.06	0.07	0.06	0.06	0.04	0.03	0.02
In percent of exports of goods and services	0.51	0.01	0.04	0.05	0.05	0.04	0.03	0.02	0.02	0.01
In percent of debt service	45.8	0.5	6.6	5.4	5.4	4.2	3.2	1.9	1.2	0.7
In percent of GDP	0.25	0.00	0.02	0.02	0.02	0.02	0.01	0.01	0.01	0.00
In percent of quota	11.9	0.1	1.0	1.2	1.3	1.1	1.0	0.7	0.5	0.3
Outstanding Fund credit										
In millions of SDRs	2.40	0.92	0.79	0.61	0.40	0.24	0.10	0.03	0.00	0.00
In millions of US\$	3.38	1.30	1.11	0.86	0.56	0.34	0.14	0.04	0.00	0.00
In percent of gross international reserves	0.55	0.22	0.19	0.14	0.10	0.06	0.03	0.01	0.00	0.00
In percent of exports of goods and services	0.50	0.18	0.15	0.12	0.08	0.04	0.02	0.00	0.00	0.00
In percent of debt service	31.5	11.3	18.5	9.3	5.5	3.1	1.1	0.3	0.0	0.0
In percent of GDP	0.24	0.09	0.07	0.05	0.03	0.02	0.01	0.00	0.00	0.00
In percent of quota	11.5	4.4	3.8	2.9	1.9	1.2	0.5	0.1	0.0	0.0
Memorandum items:										
Exports of goods and services (in US\$ millions)	679	708	725	729	740	762	861	886	913	938
Gross international reserves (in US\$ millions)	613	601	601	596	563	525	498	503	515	538
Debt service (in US\$ millions) 1/	7.6	8.1	4.3	6.5	7.2	7.7	8.9	10.3	11.7	14.0
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: Fiscal Adjustments to Fiscal Balance, 2019-23

(In percent of GDP relative to the baseline)

	2019	2020	2021	2022	2023	Fiscal Measures
Revenue	0.3	0.6	0.6	0.6	0.6	
Tax Revenue	0.3	0.6	0.6	0.6	0.6	
Income and profits	0.1	0.1	0.1	0.1	0.1	Reducing tax exemptions and improving administration and compliance
Reducing stock of tax arrears	0.2	0.4	0.4	0.4	0.4	Reducing stock of tax arrears: reduce outstanding cases Reducing outstanding returns on hand Strengthening timeframe for prosecution
International trade and transactions	0.0	0.1	0.1	0.1	0.1	Tax reference price for logs should be in line with world market prices
Expenditure	0.0	-0.5	-0.5	-0.5	-0.5	
Recurrent spending	0.0	-0.3	-0.3	-0.3	-0.3	
Compensation of employees	0.0	-0.2	-0.2	-0.2	-0.2	Containing wage bill growth below the nominal GDP growth
Other recurrent spending	0.0	-0.1	-0.1	-0.1	-0.1	Reducing spending for scholarships and other low-priority spending, such as travel
Development spending	0.0	-0.2	-0.2	-0.2	-0.2	
CDFs	0.0	-0.2	-0.2	-0.2	-0.2	Reducing CDFs, publish a supplement on CDFs planning, use of funds in 2019 Budget
Other development spending	0.0	0.0	0.0	0.0	0.0	Prioritizing and streamlining development spending: reducing shipping grants
Total Savings	0.3	1.1	1.1	1.1	1.1	
Cumulative Savings	0.3	1.4	2.5	3.6	4.7	
Adjustment Scenario						
Overall Balance (In percent of GDP)	-2.4	-2.6	-3.2	-2.7	-2.6	
Cash Balance (in S\$ millions)	269	294	354	453	603	
in months of recurrent spending	1.0	1.1	1.3	1.6	2.0	
Broader Cash Balance (in S\$ millions)	477	501	562	661	810	
in months of total spending	1.5	1.5	1.6	1.8	2.1	
Public domestic debt, including arrears (in S\$ millions)	473	449	388	275	105	
Public domestic debt, including arrears (In percent of GDP)	4.1	3.7	3.0	2.0	0.7	
Baseline Scenario						
Overall Balance (In percent of GDP)	-2.7	-3.7	-4.8	-5.0	-5.6	
Cash Balance (in S\$ millions)	240	129	-26	-238	-512	
in months of recurrent spending	0.9	0.5	-0.1	-0.8	-1.6	
Broader Cash Balance (in S\$ millions)	448	337	182	-31	-304	
in months of total spending	1.4	1.0	0.5	-0.1	-0.7	
Public domestic debt, including arrears (in S\$ millions)	502	613	768	966	1219	
Public domestic debt, including arrears (In percent of GDP)	4.3	5.1	6.0	7.1	8.4	

Source: Staff estimates.

Annex I. SDGs Identified in Solomon Islands' 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	<div style="background-color: #e67e22; color: white; padding: 5px; text-align: center;">5 Gender Equality</div> <div style="background-color: #9b59b6; color: white; padding: 5px; text-align: center;">8 Inclusive Economic Growth & Decent Work</div>	<div style="background-color: #f39c12; color: white; padding: 5px; text-align: center;">9 Resilient Infrastructure & Innovation</div> <div style="background-color: #e91e63; color: white; padding: 5px; text-align: center;">10 Reduced Inequality</div>	<ul style="list-style-type: none"> ✓ Assistance in public investment management ✓ TA on domestic revenue mobilization ✓ TA on financial stability to support financial deepening and inclusion
Poverty alleviation	<div style="background-color: #e74c3c; color: white; padding: 5px; text-align: center;">1 No Poverty</div> <div style="background-color: #c08060; color: white; padding: 5px; text-align: center;">2 Zero Hunger</div>	<div style="background-color: #3498db; color: white; padding: 5px; text-align: center;">6 Clean Water &</div>	<ul style="list-style-type: none"> ✓ Surveillance and policy advice on macro-economic policies□
Access to quality social services	<div style="background-color: #27ae60; color: white; padding: 5px; text-align: center;">3 Good Health and Well Being</div> <div style="background-color: #e74c3c; color: white; padding: 5px; text-align: center;">4 Quality Education</div>		<ul style="list-style-type: none"> ✓ Coordination with the World Bank Group and development partners ✓ Emphasis prioritization of expenditure in line with NDS
Resilient and environmental sustainable development	<div style="background-color: #f1c40f; color: white; padding: 5px; text-align: center;">7 Affordable and Clean Energy</div> <div style="background-color: #f39c12; color: white; padding: 5px; text-align: center;">11 Sustainable Cities & Communities</div> <div style="background-color: #3498db; color: white; padding: 5px; text-align: center;">14 Sustainable Use of Oceans</div>	<div style="background-color: #d35400; color: white; padding: 5px; text-align: center;">12 Responsible Consumption</div> <div style="background-color: #6aa84f; color: white; padding: 5px; text-align: center;">13 Climate Action</div> <div style="background-color: #27ae60; color: white; padding: 5px; text-align: center;">15 Protect Forests & Ecosystem</div>	<ul style="list-style-type: none"> ✓ Provide analytical and policy framework on how to incorporate the cost of natural disasters and climate change into the macroframework ✓ Capacity development
Stable and effective governance and public order	<div style="background-color: #3498db; color: white; padding: 5px; text-align: center;">16 Peace, Justice, and Strong Institution</div>	<div style="background-color: #2c3e50; color: white; padding: 5px; text-align: center;">17 Partnerships for the Goals</div>	<ul style="list-style-type: none"> ✓ TA on PFM with a particular focus on improved medium-term revenue and expenditure forecasting; stronger integration of planning and budgeting within a medium-term framework ✓ Focus on governance of logging and mining sectors

^{1/} Staff compilation.

Annex II. Authorities' Response to Fund Policy Advice

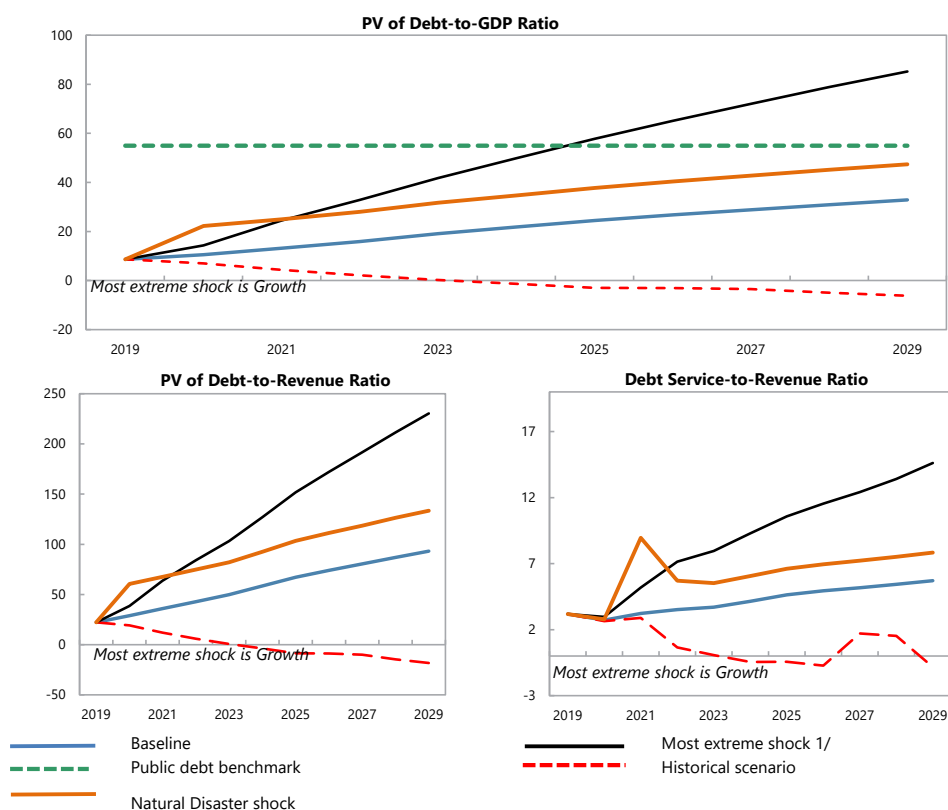
Fund Recommendation	Policy Actions
<p>Fiscal Policy</p> <p>Rebuild the cash balance, clearing domestic arrears, and prioritizing spending.</p> <p>Increase fiscal openness, transparency and planning</p> <p>Broaden the tax base and increase revenue transparency</p> <p>Promote transparency and accountability of public funds, including CDFs.</p> <p>Strengthen public financial management and present a medium-term fiscal strategy.t</p>	<p>The government's broad cash balance rose to 2 months of total spending in 2018, on unexpectedly strong revenues and the government was able to clear domestic arrears. The election period interrupted progress on fiscal reforms. Further efforts are needed to better prioritize expenditures in line with the National Development Strategy.</p> <p>The 2018 and 2019 budget documents are published on the website. The 2018 Final Budget Outcome was published in line with the Public Financial Management Act 2013. The authorities remain interested in tax reform.</p> <p>A new Customs and Excise bill (previously an ECF benchmark) was approved by Cabinet in February 2016. There is not yet a firm timeline for presenting the bill to Parliament. The tax review was launched in September 2017 to reform the current tax system. It focuses on modernizing tax administration and considering whether to make the current system work better or to introduce a value-added tax (VAT). The CDF Act has not been implemented. In April 2018, the audit report on the CDFs by the Office of Auditor General was published. The report recommended increasing citizen participation in the allocation of CDFs, implementing rigorous reporting and third-party oversight of CDF activities, and expanding project management capacity.</p> <p>The 2020 Budget strategy introduces Budgetary Committees to try and develop more strategic budget planning and coordination. However, there are significant shortcomings in expenditure control and further improvements in cash management are needed.</p>
<p>Monetary and Financial Sector Policy</p> <p>Strengthen supervisory and regulatory framework for the financial system</p> <p>A modest tightening of monetary settings was called for in 2018.</p> <p>A high priority should be given to clearing the backlog of financial legislation and strengthening the AML/CFT framework</p>	<p>The Cabinet approved the drafting instructions for a new Financial Institutions Act and started the process to draft a Credit Unions bill to promote financial sector stability and development as part of the benchmarks under the ECF. However, as of July 2018, the bills had not been submitted to Parliament.</p> <p>The CRR ratio was raised earlier this year. Since then inflation has dissipated and credit growth is modest,</p> <p>The backlog of financial legislation (and regulations) remains. The authorities underwent an AML/CFT Mutual Evaluation earlier this year; the corresponding report was published on October 2. That report notes a number of weaknesses in the Solomon Islands' AML/CFT regime, including on AML/CFT supervision, the application of preventative measures, transparency of the beneficial ownership of legal entities, and the application of targeted financial sanctions. Financial inclusion efforts are continuing.</p>
<p>Exchange rate policy and external policy buffer</p> <p>Follow the basket peg more closely and review the composition of the basket exchange rate peg on an annual basis.</p>	<p>The exchange rate basket peg continues to move in a tight band against the U.S. dollar. The authorities are interested in further CD on exchange rate management. Further progress on fiscal management and fiscal adjustment together with structural reforms would help to narrow the current account gap.</p>
<p>Structural Reforms</p> <p>Manage the transition from logging to new growth areas and put in place a strong regulatory and policy environment for the mining sector. Narrow infrastructure gaps. Structural reforms would help encourage a greater private sector role in supporting sustained growth.</p> <p>Enhance resilience to natural disasters by developing and implementing a multi-pillar strategy at the national, regional, and multilateral levels</p>	<p>The authorities are developing a new mining law with the support of the World Bank. The IMF has provided cd on bauxite pricing. On infrastructure gaps: the Tina River Hydropower Project is progressing and is expected to reduce the cost of electricity. The 2019 election delayed progress on structural reform. Legislative reforms in taxation, the mineral and logging sectors, and measures to curb corruption would contribute to improving the business environment and developing new sources of growth.</p> <p>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.</p>

Likelihood	Impact / Time Horizon		Policy Response	
Medium	High / ST, MT	Upside	<ul style="list-style-type: none"> Take advantage of upside surprises to lock in an improvement in fiscal buffers. Ensure these new sources of growth are taxed properly. Consider ways to use some of the gains to invest in resilient infrastructure. Creating favorable conditions for technology would require a sound regulatory framework, interoperability, a level playing field, and encouraging regional approaches could help. 	
	1. Reopening of Gold Ridge mine and beginning of the nickel and bauxite projects Production of mining would contribute to export growth and revenue increase.			
	High / ST, MT			
Medium /	2. Positive spillovers from large infrastructure projects The implementation of the long-standing plans for large infrastructure projects, such as the Tina Hydropower development project, could have positive spillovers on the economy from 2020 onwards.	Downside	<ul style="list-style-type: none"> Sustain the fiscal buffer. Consider measures to contain the payroll. Redouble efforts to contain spending on CDFs, tertiary scholarships and shipping grants. Contain spending on the Pacific Games and ensure financing is grants or on concessional terms. Cushion the impact. Seek additional concessional financing to ensure that critical capital expenditure projects can continue. Review and realign the basket exchange rate peg with underlying fundamentals and competitiveness. Undertake structural reforms to improve the business environment and help support diversification of the sources of growth. Finalize and complete the Tina Hydro project which will reduce dependence on oil imports and could help reduce electricity prices. Reduce environmental concerns in the logging sector. Continue to strengthen prudential standards for governance, fit and proper. Strengthen the effectiveness of the AML/CFT framework. Contribute to regional efforts to establish a regional Know Your Customer Utility. Build fiscal buffers against a natural disaster shock. 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. Invest in resilient infrastructure to strengthen climate change mitigation and adaptation. 	
High	3. Internet Undersea cable is highly effective and substantially improves connectivity. The completion of the undersea cable projects by the end of 2019 will substantially improve connectivity.			
High	High / ST, MT			
	1. Fiscal policy slippage, including spending on the Pacific Games. Expansionary fiscal policy and weak public financial management increase domestic arrears, resulting in a rise in non-performing loans in the banking sector.			
High	High / ST			2. Rising protectionism and retreat from multilateralism has a knock-on effect on logging and other trade. Main impact is through a slowdown in growth in China and the impact on logging exports.
High	High / ST, MT			3. Weaker-than-expected global growth 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.
	Medium / ST			4. Sharp swing in energy prices Risks to prices are broadly balanced, reflecting offsetting but large and uncertain supply and demand shocks. Near term uncertainty leads to price volatility. Sharp increases in prices would adversely affect Solomon Islands trade balance.
Medium / High	High / ST			5. Reduced financial services by correspondent banks (de-risking) Solomon Islands sole domestic bank Pan Oceanic Bank has established a correspondent banking relationship for US dollars with Crown Agents Bank (U.K.). This arrangement will be in place for at least three years. But a reemergence of this risk would be a significant adverse shock to the economy given a heavy economic reliance on the logging sector.
High	High / ST, MT	6. Natural disasters and climate change Solomon Islands faces many natural disasters, including tropical cyclone, drought, earthquake, tsunami, and flood in the past. Disasters could occur with higher frequency and severity due to climate change. The country also faces the risk of adverse effects of volatile weather conditions caused primarily by global warming.		

¹The 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.

Annex IV. Indicators of Public Debt Under Alternative Scenarios, 2019–29

Figure 2. Solomon Islands: Indicators of Public Debt Under Alternative Scenarios, 2019-2029



Borrowing Assumptions for Stress Tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	52%	52%
Domestic medium and long-term	36%	36%
Domestic short-term	9%	12%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	1.2%	1.2%
Avg. maturity (incl. grace period)	29	29
Avg. grace period	7	7
Domestic MLT debt		
Avg. real interest rate on new borrowing	3.1%	3.1%
Avg. maturity (incl. grace period)	15	15
Avg. grace period	14	14
Domestic short-term debt		
Avg. real interest rate	-2%	-2%

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

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

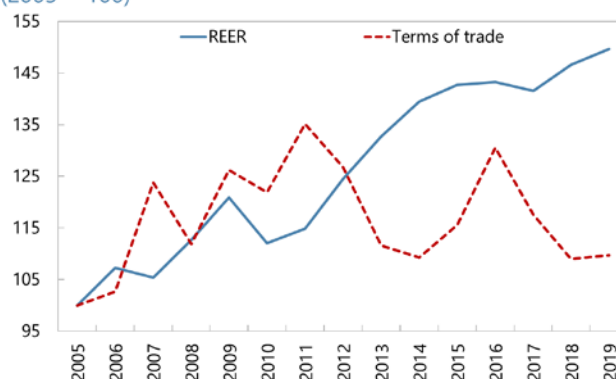
Annex V. External Sector Assessment¹

In 2019, the external sector position was assessed to be weaker than that implied by medium-term fundamentals and desirable policy settings. The current account deficit is expected to widen with a pickup in infrastructure projects and a decline in logging exports. The real exchange rate was once again stronger than warranted. While reserve coverage is adequate, it is expected to decline over time. Structural policies can help improve competitiveness and encourage export diversification and sound fiscal policies can help reduce the current account gap.

Real Exchange Rate

1. The real exchange rate appreciated in 2018 and 2019, continuing a long-run trend observed since 2005. The REER is on an upward trajectory again at a time when the terms of trade are deteriorating. While Solomon Islands still has a comfortable level of FX reserves and continues to receive external grants from development partners, a loss of competitiveness over the medium term could slow growth. Competitiveness needs to be strengthened by both structural and fiscal reforms to ensure external balance in the medium term.

Solomon Islands: REER and Terms of Trade
(2005 = 100)



Sources: IMF staff calculations

External Sector Assessment

2. The current account deficit is estimated at 8.6 percent of GDP in 2019, mainly driven by the high import content of infrastructure projects. Solomon Islands has a large infrastructure gap and investment is needed to improve transport, communications, and to help reduce energy prices.

3. The revised EBA-Lite methodology suggests that the external sector position is weaker than that consistent with medium-term fundamentals and desirable policy settings.² Based on the current account approach, the estimated cyclically-adjusted current

Revised EBA-lite CA approach	2019 (in percentage)
CA – Actual	-8.6
Cyclically adjusted CA	-7.9
Cyc. adjusted CA – Norm	-3.7
Includes additional adjustments to the norm (see 2017 AIV).	3
Elasticity	-0.38
CA – Gap (Adjusted)	-4.2
of which: policy gap	- 0.84
REER Gap (Adjusted)	11

Source: IMF staff estimates.
Note: All numbers are pps of GDP, except for the elasticity and the REER gap, which are expressed in percent.

¹ Prepared by Charlotte Sandoz (APD)

² See *Methodological Note on EBA-lite* (mimeo). Revised EBA-lite does not capture fully the characteristics of small states, hence there is significant uncertainty around the estimates.

account deficit of 7.9 percent in 2019 was higher than the adjusted current account norm of a current account deficit of 3.7 percent of GDP. The gap is 4.2 percent of GDP after controlling for cyclical factors and considering that a large share of imports is financed by capital grants, which are insensitive to exchange rate variations. This approach implies that in 2019 the real effective exchange rate was overvalued by 11 percent.

4. Based on the current account approach, the policy gap contributed to the current account gap. The regression-based model results rely on private credit growth, the change in official reserves, the share of the overseas population as a proxy of remittance inflows, a control for the health expenditure to GDP ratio and a dummy variable for natural disasters. These all affect intertemporal decisions for savings and investment and the level of the current account deficit. The policy gap increased the current account gap by 0.8 percent of GDP and it is driven by high private credit level (35 percent of GDP in 2019) and high capital controls.

5. The revised EBA-Lite methodology using the REER approach suggests the real exchange rate is overvalued by 19 percent compared to the REER norm in 2019. This is somewhat higher than the gap based on the current account approach. Over the medium term, narrow the current account deficit or sustain the international investment position.

Revised EBA-lite REER approach	2019 (in percentage)
Ln (REER) Actual	4.94
Ln (REER) Fitted	4.80
Ln (REER) Norm	4.75
Residual	0.14
REER – Gap	19%
<i>of which: policy gap</i>	5%
Source: IMF staff estimates.	

Foreign Exchange Reserves and Reserve Adequacy

6. Gross official reserves remained comfortable at US\$601 million in 2019 (around 8.1 months of prospective imports). Official reserves have slightly declined since 2017 but remained at a comfortable level. In 2018, reserves' coverage fell below 9 months of prospective imports for the first time since 2013 and the trend is expected to pursue, reflecting a widening current account deficit.

7. A cost-benefit analysis on the level of reserves held suggest an optimal level between 4 to 7 months of imports. 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 4-7 months of imports, somewhat lower than the current level of 8.1 months of prospective imports. However, the reserves' coverage is projected to gradually decline over the medium term, falling below 5 months of prospective imports by 2025. The government should take measures for sustainable logging in the forestry sector and foster export diversification to contain the growing current deficit over the medium term.

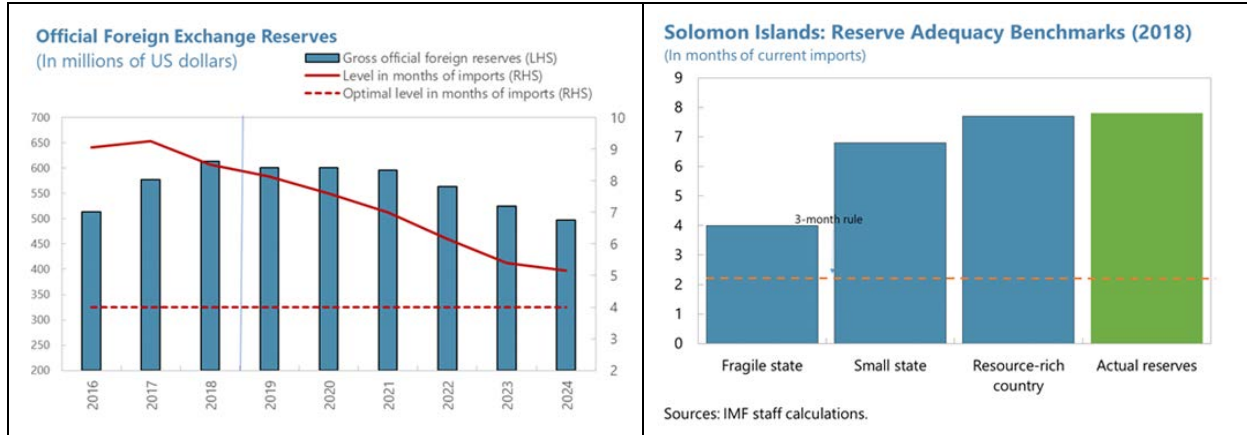


Table 1. Solomon Islands: TA Priorities for FY20 and FY21

Topic	Sub-Topic	TA Description	Functional Dept	Staff Report Paragraph	Rank	Comments
Public Financial Management	Budget execution and control.	Improved PFM laws, budget process, fiscal reporting, asset and liability management and monitoring of fiscal risks.	FAD	12, 17, 19, 21-25, 50-52	1	In 2018 a roadmap was prepared on short term improvements that are needed to strengthen PFM. TA will continue to focus on implementing the roadmap. An August 2019 mission provided TA on establishing a fixed assets framework. A future mission will review 2018 financial statements for compliance with cash IPSAS. TA is planned for FY21 on establishing a framework for recording and reporting of expenditure arrears.
	Public financial management laws and institutions.					
	Budget preparation, fiscal reporting and asset management.					
Revenue Administration	Tax administration and core functions.	Better management and governance arrangements of core functions.	FAD	17,19-20, 24, 50-51.	2	TA has been provided on the management of tax debts and returns, reviewing the revenue administration roadmap, setting up a Large Taxpayer Office and function based structure for the Inland Revenue. Staff are offering TA on a medium-term revenue strategy and for the VAT reform in coordination with ADB.
Tax Policy	Tax and non-tax revenue policy.		FAD	17, 19-20 51.	3	Medium term revenue strategy and VAT reform in coordination with ADB. TA received on pricing for bauxite and nickel mining. Additional TA on wider fiscal issues in mining could be forthcoming in FY21.
Financial Supervision and Regulation	Risk based supervision and systemic risk monitoring.	Stronger banking regulations & prudential norms; and implementation of a risk-based supervision system and supervisory processes.	MCM	30-32, 34, 57.	4	Under the Supervision Framework Enhancement Program and with the assistance of PFTAC, the CBSI has developed a draft risk rating and supervisory action framework, built capacity to undertake liquidity and market risk assessments and begun to revise prudential standards. Once the work on standards is completed in FY20 FY21 will be used to consolidate and embed reforms.

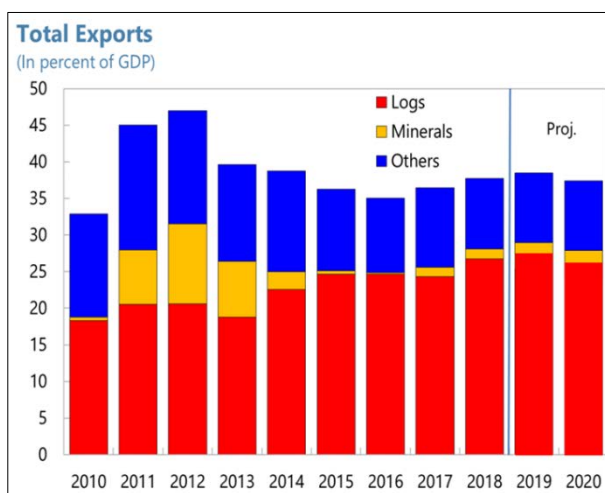
Table 1. Solomon Islands: TA Priorities for FY20 and FY21 (Concluded)

Topic	Sub-Topic	TA Description	Functional Dept	Staff Report Paragraph	Rank	Comments
Central Bank Operations	FOREX reserve management.		MCM	26, Annex. V	5	CBSI is seeking additional TA with targeted support on operations.
AML/CFT	Measures to address CBR pressures		LEG	30-31, 34, 57.	6	Staff provided a training workshop at STI and another is planned for FY2020. Staff also set up and participated in the Pacific Roundtables on CBR pressures. Staff are supporting a secretariat to develop a regional know your customer utility.
General macro analysis	Financial Programming and policies (FPP)	Sound medium-term macroeconomic programming framework	ICD	11-15, 40, 49.	7	The CBSI and Ministry of Finance both regularly use a macroeconomic and fiscal framework model for GDP forecasting and set an example in the region for interagency collaboration. Priorities for future TA include continuing to foster good collaboration and support the MOF and CBSI efforts to provide advice to ministers on the implications of tax and other reforms.
Debt Management	Medium term debt strategy and DSA workshop		MCM	13, 15,16	8	Solomon Islands will participate in regional training on the new LIC debt sustainability analysis. Work on GFS statistics continues (see below).
Strengthen Macroeconomic and Financial Statistics	Real sector – National account, government finance and balance of payment	Stronger compilation and dissemination of macro & financial statistics	STA	6, 23, 27	9	Rebased GDP estimates have yet to be published. The next mission will focus on looking at the non response rate of the 2017 business register and on methods for data imputation for gaps. TA on the compilation of GFS statistics will continue including expanding public debt statistics to cover general government and public corporations.

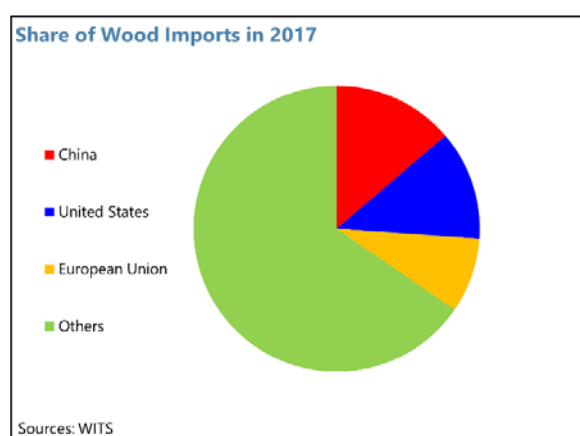
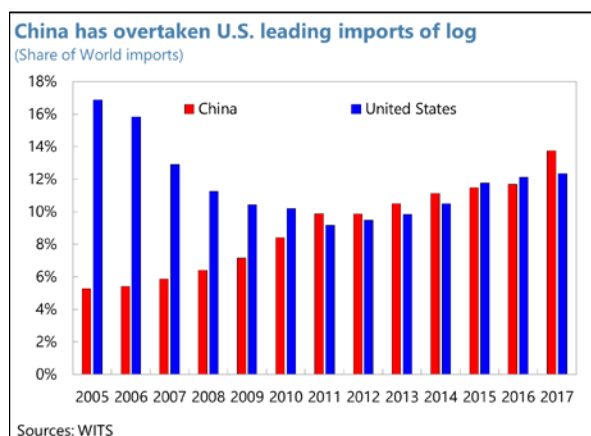
Annex VII. Medium- and Long-Term Growth Opportunities¹

A. Introduction

1. The Solomon Islands' economy has been highly dependent on logging activity for decades. Logging began in the 1930s on crown land and intensified until the 1980s when crown land was depleted. Since the late 1980s, commercial logging switched to customary land—around 87 percent of Solomon Islands' land is customary-owned—with contracts between mainly foreign-owned firms and customary land owners. Since the late 1980s, the rate of extraction of logging has been massively above the sustainable rate, although there have been periodic efforts to control the industry. Between 2006 and 2018 logging grew by 15 percent per year and represented 60 percent of domestic exports on average. Logging accounted for 22 percent of government revenues and 10 percent of GDP in 2018. Nearly half of the workforce is thought to be directly or indirectly associated with the logging sector. The World Bank estimates that logging activity is at about 17 times the sustainable rate of extraction, causing rapid deforestation.



2. Logging production is mainly exported to Asia, including China which has overtaken the U.S. as the world's largest importer. China accounted for 14 percent of global imports of wood and was the largest importer in the world in 2017.² Since exports by Solomon Islands to the



¹ Prepared by Charlotte Sandoz with research assistance by Haopeng Xu.

² WITS/World Bank database [https://wits.worldbank.org/CountryProfile/en/Compare/country/CHN/indicator/MPRT-TRD-VL/partner/WLD/product/44-49 Wood/country/ECS/show/line](https://wits.worldbank.org/CountryProfile/en/Compare/country/CHN/indicator/MPRT-TRD-VL/partner/WLD/product/44-49%20Wood/country/ECS/show/line)

USA, European Union and Canada are prohibited due to import regulations (including on illegally-harvested timber or timber products), logging exports are highly concentrated and dependent on demand from Asia and in particular China, and demand has slowed in 2019.³

3. The authorities are introducing a logging sustainability policy, with a view to restoring the reputation the industry and maintaining logging as an export activity. This will toughen regulations to combat illegal logging and will ban the exports of small-sized round logs. Effective implementation of the sustainability policy would imply a halving of logging activity by 2023. Some provinces in Solomon Islands are also taking their own actions. For example, in early 2019 the Central Island Province stopped issuing new business licenses for logging to protect the environment and biodiversity. However, across all the Provinces, the authorities face a difficult task in successfully implementing a sustainability policy. Previous attempts to reduce uncontrolled logging have been unsuccessful. Regulatory enforcement is currently lax, and the industry is largely controlled by foreign companies.

4. The authorities face the added pressure of providing jobs for a rapidly growing labor force. The labor force grew by more than 2.5 percent per year between 2005 and 2017, and the participation rate for ages 15–25 was around 60 percent. The unemployment rate remains high (about 70 percent in 2013⁴) and higher job creation would be needed to ensure a sustainable and inclusive growth.

5. Against this backdrop, it is clear that new activities or approaches are needed to support growth over the medium term – but which activities could compensate and how?

Three channels of diversification appear feasible:

- *Mining sector.* Solomon Islands has world class nickel deposits, and significant gold and bauxite and could benefit from relatively high global demand for these commodities. However, this brings with it conflict and environmental risks. Reaping benefits from the mining sector would require a strong regulatory and policy environment, and the fiscal regime needs to be strictly enforced to ensure revenue generation benefits Solomon Islanders.
- *Agricultural food products* could be directed to domestic consumption and substitute for imports. In addition, a stronger specialization in niche markets to increase production of soft commodities such as copra and seaweed could improve Solomon Islands' comparative advantage in global markets and stimulate export growth over the long term.
- *Undersea internet cable, connectivity and transport infrastructure.* The forthcoming upgrades of transport infrastructure and improving connectivity could support further development of economic activity especially in the tourism and agriculture sectors, and promote a more efficient use of available resources.

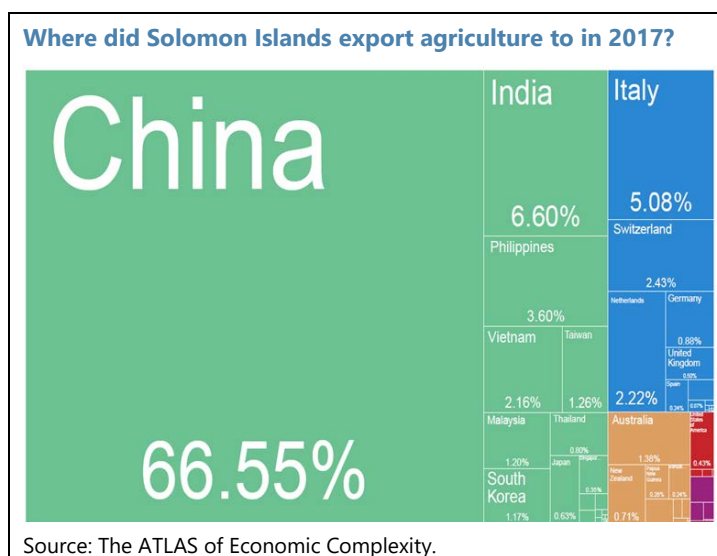
³ <https://sustainableforestproducts.org/Legality>

⁴ World Development Indicators from the World Bank database

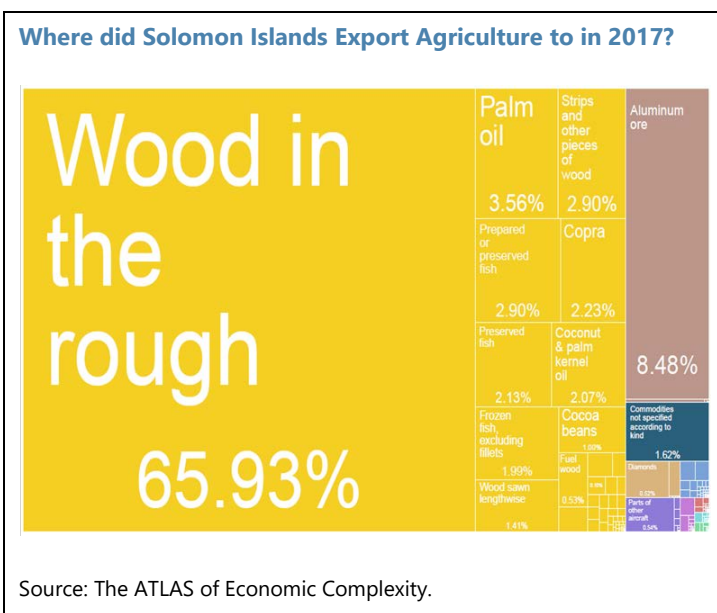
6. Improving the quality of institutions and infrastructure will also be critical to support diversification. A conducive and competitive business environment favors innovation, investment in the private sector and the creation of new businesses which support job creation. In Solomon Islands, the slow pace of legislative and policy reforms, land tenure, and governance remain key impediments to development. Ensuring that the policy and regulatory environment sufficiently addresses and curtails environmental and governance concerns in the logging and mining sectors is a major challenge.

B. Export Diversification in an Overall Growth Strategy

7. Many developing countries have aimed at export diversification to guard against unexpected demand shocks which bring economic instability. Island economies are often characterized by large trade openness with exports concentrated within a narrow range of products. Integrating export diversification into an overall growth strategy would help to stabilize economic growth which is highly relevant for vulnerable economies such as Solomon Islands (see Vanuatu Article IV Consultation, 2018).



8. A country can diversify its exports by entering new product lines, exporting to new partners, or by upgrading the quality of existing products. China is the first trade partner of Solomon Islands but Solomon Islands has expanded into a variety of new markets since 2007. For instance, they have started to export some agricultural products to Saudi Arabia and South Africa, among others. Improving quality of logging towards sustainable practices could help reopen some export destinations. An expansion of agricultural commodities produced in Solomon Islands and tourism would help to diversify export destinations. Sectoral diversification is more difficult

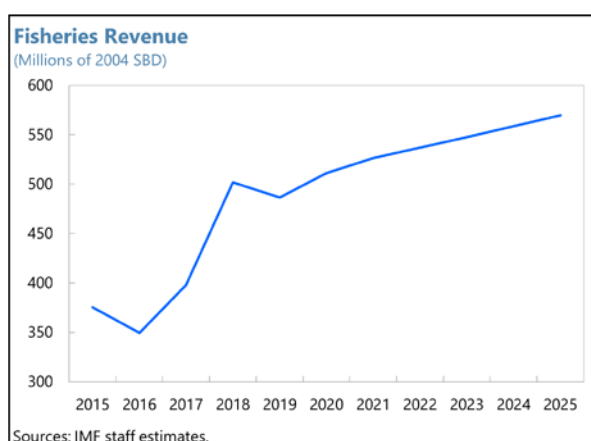


for remote islands, but connectivity may improve the scope for service industries and increased labor mobility—including through the seasonal worker schemes—could contribute.

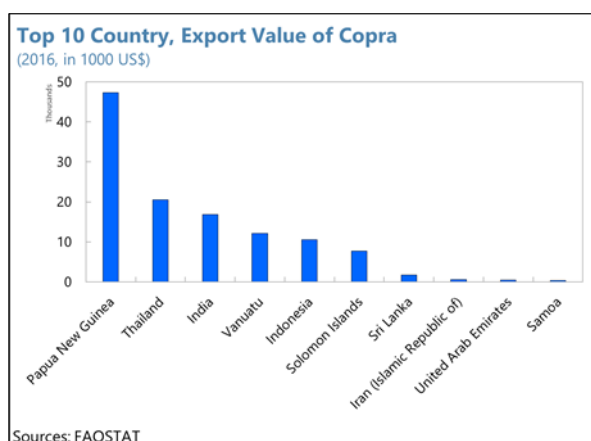
C. Potential Growth Industries

9. Potential for mining-related activities is large enough to provide a significant offset to the decline in logging activities in the medium term. Rehabilitation of the Gold Ridge, development of nickel, and exploration for bauxite opportunities, could increase foreign direct investment, supporting growth and improving external balance. However, commodities prices need to remain high to incentivize further development and ensure long-term profitability. The authorities also need to implement reforms in the mining sector that push for sharing benefits among investors, land owners, and the government as well as preventing corruption and environmental damage.

10. Fisheries is also a sector with potentially large revenues. The gross value of exports of fish, crustacean and mollusks, and preparation, almost doubled between 2005 and 2017, reaching 6 percent of total exports in 2017. Solomon Islands is one of the Parties to the Nauru Agreement covering rules for fishing and cooperation in the management of fisheries. In 2018, fishing revenues performed well with higher license fees and higher activity through the Agreement. Solomon Islands has space under the agreement to further intensify its fishing to get higher returns on fishing licenses. There is also scope to further develop tuna canning—some activity in this direction is being supported by technical assistance from the E.U.



11. Agriculture diversification would reduce reliance on food imports, improve the external balance and stimulate domestic consumption. In 2016, rice, meat and palm oil were among the top 10 of commodities imported in Solomon Islands and some of them could be produced domestically. For instance, rice is the key regional staple and the main food imported to the Solomon Islands. In 2017, Solomon Islands exported USD 549 million of rice to PNG and Nauru, while they imported USD 16 million from Vietnam.⁵ Aside from reducing the external



⁵ <http://atlas.cid.harvard.edu/explore?country=195&product=741&year=2017&productClass=HS&target=Product&partner=undefined&startYear=undefined>

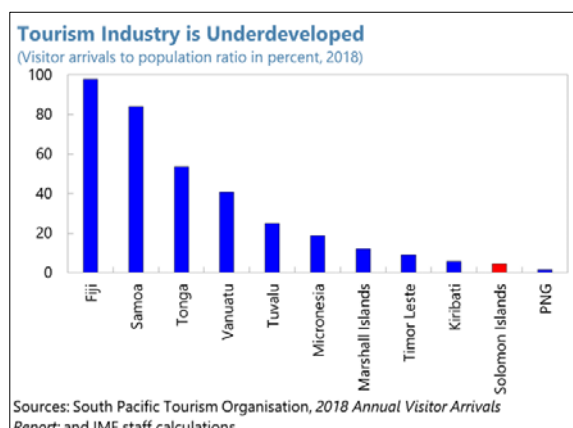
deficit, a better management of domestic food supply would create new source of value-added and increase domestic consumption.

12. Solomon Islands benefits from favorable conditions to produce copra, seaweed, palm oil and cocoa. They were the 6th biggest exporters of copra and 10th largest farmed seaweed producers in the world in 2016. There is also potential for palm oil activity to expand and the Guadalcanal Palm oil Plantation Limited has secured a sustainable palm oil certification. In palm oil and cocoa Solomon Islands faces tough price competition from others in the Pacific, and Indonesia and Malaysia who are large exporters with lower marginal production cost and transportation costs. Fostering specialization in niche markets such as copra and seaweed faces fewer hurdles.

13. The tourism sector will benefit from the upgrades to key roads and airport development in key provinces , as well as from increased connectivity. Travel and tourism

represented 7 percent of total exports and about 50 percent of total export of services in 2017. In March 2019, the World Bank agreed to fund US\$51million of infrastructure projects in Honiara, Munda and Malaita for airports and roads. The New Zealand authorities are also engaged in air strip development in key islands. Combined with the positive outlook for tourism industry in the Pacific, tourism arrivals are likely to rise over the medium term, and this is a sector that can improve

women's economic empowerment. IFC analysis indicates that Solomon Islands tourism has potential from tropical climate, coral reefs, beaches, lagoons, surf breaks unique cultural heritage and World War II sites, but leisure visitors are currently small in scale by regional standards. Competition from other PICs like Fiji, PNG, Palau, Samoa and Vanuatu can make it difficult to gain market share without a global strategy to attract tourists and a good cooperation between public and private actors (Vanuatu AIV, 2019). Given the infrastructure gaps and complex coordination challenges, tourism development will take time.



D. Connectivity and Economic Development

14. Solomon Islands can also leverage gains from connectivity in the education and health sectors. The human development index is very low for Solomon Islands. Improved connectivity has the potential to accelerate the spread of knowledge and adoption of productivity-enhancing technologies, helping to close productivity gap to other countries. For example, in Samoa, the provision of e-learning material for teachers and students has contributed to

improving Samoa's education indicators. In Samoa, between 2000 and 2015 the poverty rate declined from 27 percent to 19 percent and primary school enrolment significantly increased. ICT also has the potential to transform the delivery of health services in ways that not only increase efficiency but also improve accountability. For instance, work in Tonga is enabling doctors to communicate more easily via live-feeds with health workers on other islands and doctors overseas during surgery (World Bank, 2013).

15. The World Bank

estimates that ICT-related opportunities could lead to additional per capita income growth of 7-10 percent the Solomon Islands. Under the opportunity scenario, where countries reach a mobile penetration rate of 85 percent by 2040, productivity increases in agriculture could generate 1.1 percent more in annual growth for Solomon Islands by 2040. They could also see additional growth in the tourism and manufacturing industries through the adoption of new technologies and higher productivity (World Bank, 2017).

16. However, favorable conditions are needed for technology adoption to be effective.

Achieving faster growth under the opportunity scenario designed by the World Bank would require addressing key remaining connectivity issues such as limited infrastructure and weak legal/regulatory framework. Complementary factors such as human capital, and market liberalization play an important role in accelerating the benefits of ICT investment both for firms and for countries (World Bank, 2017).

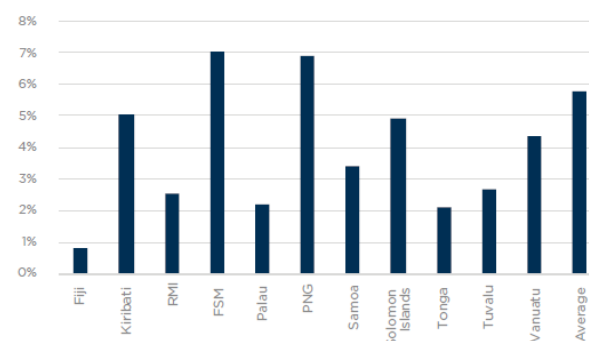
Human Development Index in Pacific Islands

HDI rank	Country	Human Development Index (HDI) Value	Life expectancy at birth (years)	Expected years of schooling (years)	Mean years of schooling (years)	GNI per capita (2011 PPP \$)
60	Palau	0.780	72.7	13.7	12.3	13,496
90	Fiji	0.727	70.0	15.7	9.9	7,493
100	Tonga	0.717	72.8	14.7	10.7	5,069
105	Samoa	0.702	73.4	12.9	10.3	5,327
123	Fed. St. Micronesia	0.640	69.1	11.7	9.7	3,432
133	Timor-Leste	0.595	68.2	11.7	4.4	5,363
134	Vanuatu	0.594	71.9	10.6	6.8	2,803
137	Kiribati	0.590	66.0	12.3	7.8	2,434
156	Solomon Islands	0.506	67.9	9.2	5.0	1,540
158	Papua New Guinea	0.505	62.6	9.9	4.0	2,463

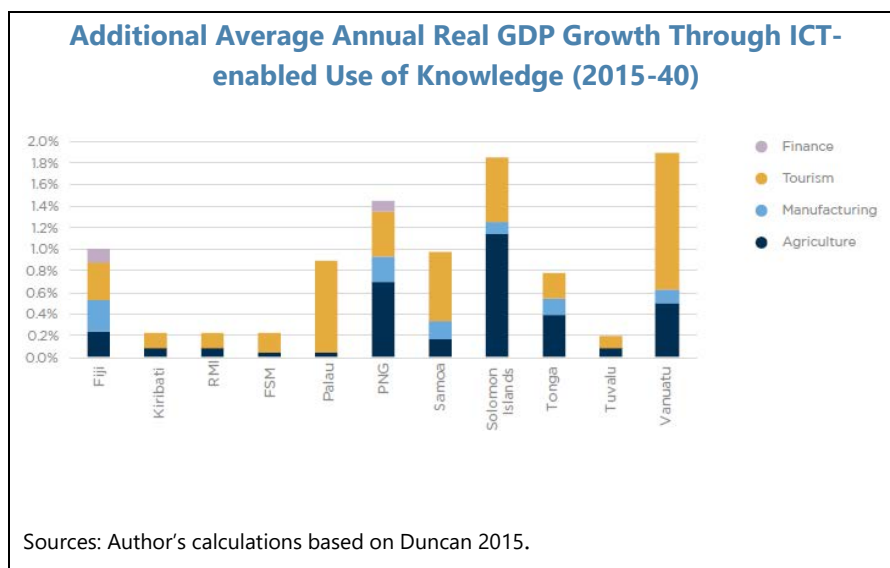
Sources: UNDP (2017).

Notes: Dark green denotes countries with 'high' human development; light green with 'medium' human development; white with 'low' human development.

Required Annual Growth in Unique Mobile Subscribers to Reach a Penetration Rate of 85 percent by 2040



Sources: World Bank staff calculations.

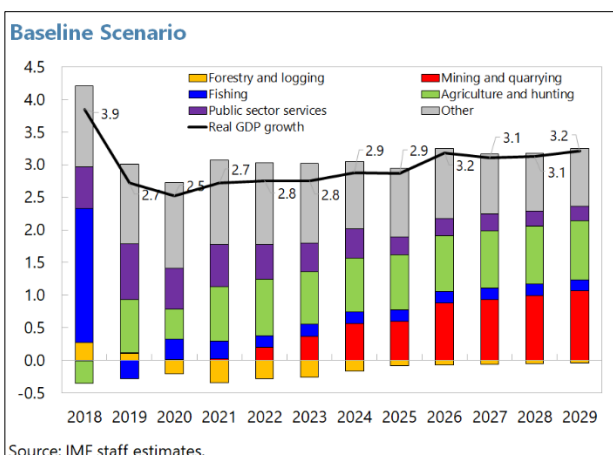


E. Conclusion

17. Staff's analysis, drawing also on the work of the World Bank and ADB, suggests there is scope for diversification to support economic growth, although there are major challenges.

Mining, fisheries, agriculture and tourism have potential for development and could also help reduce the concentration of export destinations.

From the sectoral analysis, staff developed the baseline growth scenario used in the Staff Report where logging activity is expected to decline on average by 2 percent per year in 2020–25 and there is a gradual expansion of the mining sector from 2022–2029. The agriculture fisheries and tourism sectors are assumed to develop at a much slower pace—and these could pose an upside risk to our baseline. On the downside, slower development of the mining sector could lead to a sharper slowdown in growth in the near term (see paragraph 14).



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SOLOMON ISLANDS

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 21, 2020

Prepared By

Asia and Pacific Department
(In consultation with other departments)

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FUND RELATIONS

(As of December 31, 2019)

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	1.15	11.60

Outstanding Purchases and Loans:

	SDR Million	Percent of Quota
ECF Arrangements	0.92	4.43

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				
	2020	2021	2022	2023	2024
Principal	0.13	0.18	0.21	0.16	0.13
Charges/Interest	0.07	0.06	0.06	0.06	0.06
Total	0.20	0.24	0.27	0.23	0.20

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 2018 Article IV Consultation discussions were held in Honiara during July 18-31, 2018. The staff report (IMF Country Report No. 18/309) was considered by the Executive Board and the consultation concluded on November 8, 2018.

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

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

RELATIONS WITH OTHER IFIS

Relations with other IFIS:

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

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. PFTAC has provided technical assistance to assist with rebasing GDP estimates from 2004 to 2012. Rebased estimates are overdue and need to be published as soon as possible.	
Price statistics: A monthly consumer price index (CPI) is produced with a short lag (about a month), but only covered the capital Honiara. Starting in 2019, the authorities have expanded the coverage in order to compile a nationwide CPI, with assistance from the Australian Bureau of Statistics. The index weights have also been revised using the results of the 2012/13 Household Income and Expenditure Survey. In 2019, the authorities shifted entirely to the Nationwide CPI, which includes provincial urban centers of Honiara, Auki, Noro and Gizo.	
Government finance statistics: Monthly fiscal data for the central government are published by the Ministry of Finance and Treasury (MOFT), according to the national presentation. The authorities also collect disbursement information on donors' grants, including those unappropriated in the budget, however the CBSI data collected by the BOP unit and that of the MOFT does not reconcile. Monthly public sector debt data are published, and the quality of debt data has improved through better coordination between the MOFT and the Central Bank of Solomon Islands (CBSI). Public sector debt statistics for the central government are submitted to the World Bank debt database, quarterly and annually. 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, however the CBSI publish data quarterly and annually through the CBSI bulletins in line with the <i>GFSM 2014</i> . PFTAC is working with the authorities to improve the quality of statistics, including expanding institutional coverage.	
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. The CBSI reports data on several series indicators of the Financial Access Survey (FAS) including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).	
Financial Soundness Indicators: Financial soundness indicators are reported annually. We are working with the authorities to resume quarterly submissions to STA.	
External Sector Statistics: The CBSI has been compiling quarterly balance of payment (BOPS) and international investment position (IIP) statistics by using data sources such as the Foreign Exchange Transaction System (FET) and different surveys. Coordinated Direct Investment Data (CDIS) have been compiled since 2014. These data are reported to IMF Statistics Department. The CBSI has also compiled quarterly Gross External Debt Position Public Sector Debt, Publicly-Guaranteed Private Sector Debt, and Private Sector Debt Not Publicly Guaranteed. These data are disseminated in the World Bank Quarterly External Debt Statistics (QEDS) database. Solomon Islands has been one of the beneficiaries of the Japan Administered Account (JSA) Project on the improvement of external sector statistics (ESS). Several technical assistance (TA) missions have been conducted under this project. The last one was conducted in April 2018. ESS have been improved and are now broadly considered compliant with the <i>BPM6</i> . Despite the progress achieved, limitations in the scope, classifications, and dissemination of ESS remain that distort Solomon Island's external macroeconomic accounts.	
II. Data Standards and Quality	
Solomon Islands is a participant of the Enhanced General Data Dissemination System (e-GDDS).	No data ROSC is available.
III. Reporting to STA (Optional)	
Solomon Islands reports annual government finance statistics to STA. Currently, data are available for budgetary central government for 2011–16.	

Solomon Islands: Table of Common Indicators Required for Surveillance (As of December 2019)					
	Date of latest observation	Date received	Frequency of Data 7/	Frequency of Reporting 7/	Frequency of Publication 7/
Exchange Rates	Dec-19	Dec-19	D	W	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities 1/	Sep-19	Sep-19	M	M	M
Reserve/Base Money	Sep-19	Sep-19	M	M	M
Broad Money	Sep-19	Sep-19	M	M	M
Central Bank Balance Sheet	Sep-19	Dec-19	M	M	M
Consolidated Balance Sheet of the Banking System	Sep-19	Dec-19	M	M	M
Interest Rates 2/	Nov-19	Dec-19	M	M	M
Consumer Price Index	Aug-19	Aug-19	M	M	M
Revenue, Expenditure, Balance and Composition of Financing 3/ – General Government 4/	NA	NA	NA	NA	NA
Revenue, Expenditure, Balance and Composition of Financing 3/– Central Government	Sep-19	Sep-19	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt 5/	Dec-19	Dec-19	M	M	M
External Current Account Balance	Jun-19	Sep-19	Q	Q	Q
Exports and Imports of Goods and Services	Aug-19	Aug-19	Q	Q	Q
GDP/GNP (GDP production)	2018 (Production 2014)	2019 (Production 2014)	A	A	A
Gross External Debt	Oct-19	Oct-19	Q	Q	Q
International Investment Position 6/	Jun-2019	Sep-19	Q	Q	Q
<p>1/ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.</p> <p>2/ Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.</p> <p>3/ Foreign, domestic bank, and domestic nonbank financing.</p> <p>4/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.</p> <p>5/ Including currency and maturity composition.</p> <p>6/ Includes external gross financial asset and liability positions vis-à-vis nonresidents.</p> <p>7/ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); and not available (NA).</p>					



SOLOMON ISLANDS

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION— DEBT SUSTAINABILITY ANALYSIS¹

January 21, 2020

Approved By
Jonathan D. Ostry (IMF)
Marcelo Estevão (IDA)

Prepared by the staffs of the International Monetary Fund and the International Development Association

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

The external risk of debt distress rating for Solomon Islands has been maintained at moderate, given the high uncertainty surrounding medium-term growth prospects and the possibility of debt-financed spending for the Pacific Games. All external debt indicators remain below the relevant indicative thresholds under the baseline scenario but breach thresholds under the extreme stress test scenario (export shock). In a downside scenario, with a sharper decline in logging activities in 2020 and additional loans for the Pacific Games, an export shock would cause a prolonged breach of the thresholds of both the PV of external debt-to-GDP ratio and debt-to-exports ratio. The overall risk of debt distress remains moderate, reflecting a deteriorating fiscal position. Although the PV of public debt-to-GDP ratio remains below the 55 percent threshold under the baseline scenario, it would breach the threshold under the most extreme stress test (real GDP growth) from 2025 until the end of the projection period. A tailored natural disaster shock, which uses a shock of similar scale to the largest shock in Solomon Islands' history, causes a significant deterioration in debt sustainability in the aftermath of the event. To rebuild fiscal buffers and to enhance resilience against shocks, both stronger revenue mobilization measures and expenditure rationalization are needed. Although the DSA suggests there is space to absorb a shock, Solomon Islands often faces fiscal liquidity problems due to weak public financial management and the cash balance is currently at a low level.

¹ The Solomon Islands Composite Indicator (CI) index, calculated based on the October 2019 WEO, is 2.72, indicating that the country's debt-carrying capacity is moderate. The classification of capacity has shifted from weak to moderate compared to the 2018 DSA, the calculation based on October 2018 WEO also signaled a moderate classification. Two consecutive signals are required for a shift in capacity classification according to the new "Guidance Note on the Bank-Fund Debt Sustainability Framework for Low-income Countries" (<http://www.imf.org/en/Publications/Policy-Papers/Issues/2018/02/14/pp122617guidance-note-on-lic-dsf>). The relevant indicative thresholds for the category are: 40 percent for the PV of debt-to-GDP ratio, 180 percent for the PV of debt-to-exports 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.

PUBLIC DEBT COVERAGE

1. The coverage of public sector debt used in this report is central government debt, central government-guaranteed debt, and central bank debt, which is borrowed on behalf of the government.² As of end-2017, central government-guaranteed debt were at US\$15 million for Investment Corporation Solomon Islands, Solomon Islands Broadcasting Corporation, Solomon Islands Electricity Authority, Solomon Airlines, Solomon Postal and Western Province. The outstanding debts to all multilaterals (IMF, WB, ADB) stood at US\$28.2 million (about 2 percent of GDP).

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

BACKGROUND ON DEBT

2. Public debt remained steady at around 9.4 percent of GDP in 2018 following an increase in 2017. In 2017, public debt rose by 1.6 pps of GDP and the pick-up in debt was due mainly to the issuance of domestic development bonds and disbursements from multilateral donors. In 2018, the government cleared 2017 and 2018 domestic arrears, which had been included as part of domestic financing. In addition, disbursements from multilateral donors were lower than expected in 2018. The Tina River Hydro project (TRHDP) has been delayed and is expected to begin in 2020. The government debt management framework sets a limit for the public debt-to-GDP ratio at 35 percent in nominal terms and for the debt-service-to-domestically-sourced-revenue ratio at 10 percent.

3. Public and Publicly Guaranteed (PPG) external debt stood at US\$98 million (7.2 percent of GDP) as of end-2018. The International Development Association (IDA) and the Asian Development Bank (ADB) account for 39 percent and 50 percent of total public debt respectively. There were no explicit contingent liabilities—external debt guaranteed by the government—in 2018. Private sector external debt amounted to 0.9 percent of GDP in 2018.

4. Public domestic debt increased to SI\$245 million (2.2 percent of GDP) at end-2018. The government issued SI\$30 million in domestic development bonds in 2018, in addition to the SI\$150 million

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

in domestic development bonds issued in 2017, both purchased by the Solomon Islands National Provident Fund (SINPF). In 2018, contingent liabilities for SOEs and Western Province stood at US\$19 million.

5. Both public and external borrowings are expected to grow in the medium term. The government maintained its annual borrowing limit at SI\$300 million in the 2019 budget³ to finance key infrastructure projects, including the TRHDP and the Solomon Islands Submarine Cable Project, which are supported by many development partners, including Green Climate Fund, IDA, ADB, Australia and Korea.

COUNTRY CLASSIFICATION

6. As discussed in footnote 1, the country's debt-carrying capacity applied in the 2019 DSA is medium. The Solomon Islands' Composite Indicator (CI) index, has been calculated based on the October 2019 WEO, is 2.72, indicating that the country's debt-carrying capacity is medium in the revised LIC-DSA framework. The classification has changed compared to the 2018 DSA after two consecutive signals in October 2018 and April 2019 WEO.

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	2.942	1.13	42%
Real growth rate (in percent)	2.719	2.894	0.08	3%
Import coverage of reserves (in percent)	4.052	54.214	2.20	81%
Import coverage of reserves ² (in percent)	-3.990	29.392	-1.17	-43%
Remittances (in percent)	2.022	0.000	0.00	0%
World economic growth (in percent)	13.520	3.559	0.48	18%
CI Score			2.72	100%
CI rating			Medium	

³ The 2020 Annual Borrowing Limit will be set as part of the budget process and will include all forms of public debt obligations such as direct borrowing by the Government, direct borrowing by SOEs, on lending arrangements and guarantees provided by the Government. A debt sustainability analysis is also undertaken annually, as part of the budget process, to determine an appropriate Annual Borrowing Limit.

BACKGROUND ON MACRO FORECASTS

A. Baseline Scenario

7. The assumptions in the baseline scenario are similar to the previous DSA. The baseline scenario incorporates the effect of natural disasters and climate change over the longer-term. The years 2019–24 are assumed to be disaster free to simplify the policy discussion of the near-term outlook. However, from 2025 onwards, the baseline incorporates the average long-term effects of natural disasters and climate change by lowering GDP growth by 0.3 percentage points (pps) annually, raising the current account deficit by 0.5 pps and increasing the fiscal deficit by 0.2 pps. The discount rate used to calculate the net present value of external debt remains at 5 percent. These are consistent with the findings of staff’s research on the impact of natural disasters.⁴ The main assumptions are:

- **Real GDP growth** is projected at 2.8 percent on average during 2019–29. The projection takes into account following factors: (i) on the upside, higher capital spending on key infrastructure projects, including TRHDP, the undersea cable project, and investments in road and air transport infrastructure, pushes growth up; but (ii) on the downside, these are outweighed by the risks from lax fiscal policy, a decline in logging activity, and global trade tensions due to close trade links with China.
- **Inflation** (measured by GDP deflator in USD terms) is projected to average 3.2 percent during 2019–29.
- **Non-interest current account deficit** is projected to widen to 10.3 percent of GDP on average over 2019–29 reflecting a high import content for key infrastructure projects and lower exports due to a long-term decline in logging activities. The reopening of the Gold Ridge Mine and the resumption of exports is now expected to be delayed until 2023. Gold production is assumed to peak from 2024 to 2027 and then to decrease gradually. Other mining activity (nickel and bauxite) is expected to come fully onstream over the longer run, this raises long-term growth rates slightly.
- **FDI inflows** are expected to increase on average to about 3.6 percent of GDP over 2019–29, slightly higher than last year’s projection.
- **External borrowing and grants:** new disbursements for projects in the pipeline, including TRHDP, are expected to take place in the next five years (2019–24). From 2025 onwards, the level of new external borrowing is expected to be around 3 percent of GDP. Grants and the grant element of new borrowing are expected to decline over the medium term.

⁴ Please see the detail in the IMF Working paper 18/108, “The Economic Impact of Natural Disaster in Pacific Island Countries”.

- **Fiscal outlook:** the ten-year average of primary deficit is expected to increase at 3.9 percent of GDP during 2019–29. Domestic revenues are expected to decline over the medium term due to reduced logging exports whereas spending pressures from wage increases, constituency development funds and other non-priority spending are likely to remain high.

Solomon Islands: Baseline Macroeconomic Assumptions			
(In percent of GDP, unless otherwise stated)			
	2019 Baseline	Customized Scenario	2018 DSA
	2019-29 ave.	2019-29 ave.	2018-28 ave.
Real GDP growth	2.8	2.6	2.9
GDP deflator in US dollar terms (change in percent)	3.2	3.2	4.2
Non-interest current account deficit	10.3	11.7	7.2
Net FDI (negative = inflow)	-3.6	-3.6	-3.1
Primary deficit	3.9	6.1	3.5

Source: IMF staff projections.

8. The realism tool highlights that assumptions on the primary balance are conservative (Figure 4). The deterioration in the primary deficit between 2018 and 2021 of 3 percent of GDP reflects declining revenues and increased spending based on current plans. The deteriorating fiscal position is based on conservative assumptions for declining revenue from logging activities and an increase in current spending. The assumption on real growth in 2019-2020 is lower than the projected growth paths calculated by the model since we expect the drag from the decline in logging to exceed any boost to growth from investment spending over the next few years. Two charts on public and private investment rates and their contribution to real GDP are not available due to a lack of data on the split between public and private investment.

SCENARIO STRESS TESTS

A. Natural Disaster Stress Test and Standard Tests

9. Given the severity and frequency of natural disasters in Solomon Islands, a tailored stress test for natural disaster shock was conducted. Solomon Islands is defined as a small developing natural disaster-prone state in the IMF board paper on small states and is automatically subject to the standard natural disaster shock.⁵ In addition, a tailored shock was included. This is based on EM-DAT, the international disaster database, which shows that the country's largest damage from natural disasters

⁵ One-off shock of 10 percentage points of GDP to debt-GDP ratio in the second year of the projection period (2020 for this case). Real GDP growth and exports are lowered by 1.5 and 3.5 percentage points, respectively, in the year of the shock.

during 1980–2016 was 14 percent of GDP. Thus, the DSA assumes a one-off shock of 14 pps to GDP on the debt-to-GDP ratio in 2020 and a reduction in real GDP growth and exports by 2.5 and 7.0 pps respectively.⁶

10. A stress test for the combined contingent liability shock adjusts the default setting for SOE debts. Explicit contingent liabilities, namely government-guaranteed debts, are already included in public debt. To reflect the level of implicit contingent liabilities (1.2 percent of GDP in 2018), we adjust the magnitude of the shock of SOE debts from the default value of 2 percent. We use the default value of 5 percent for financial markets.

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

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

B. Customized Downside Growth Scenario

11. Given the uncertainty surrounding medium-term growth prospects, staff also constructed a customized downside growth scenario with a contraction of logging activity by 10 percent in 2020, a delay in mining activity picking up, and debt financing for the Pacific Games. This shock is estimated to lead to a reduction of real GDP growth by 1.2 pps in 2020, equivalent to 1.5 SD of GDP growth in 2012-18. Growth is projected to return to its initial path after 2025. The 2019-29 average GDP growth rate is 0.2 pp lower than the baseline. The non-interest current account deficit would be 1.7 pps lower due to a sharp contraction in logging exports, but net FDI remains at the same level as in the baseline. The ten-year average of primary deficit is projected at 6.1 percent.

12. Funding for the Pacific games is uncertain, we assume that USD 200 million in loans would be contracted to build infrastructure in the downside scenario. Solomon Islands will host Pacific games in 2023 but the current infrastructure is inadequate. The authorities expect to finance the Games through external grants and grant financing is being obtained for a turnkey stadium. However, further additional major infrastructure and accommodation are required to support this major event and financing has not yet been secured for these investments. The authorities will seek grant financing for the infrastructure investment (and this is assumed in the baseline) but there is a risk that grant financing proves difficult to obtain. In the downside scenario, we assume that financing is provided as external loans and on non concessional terms.

⁶ Please see the detail in Lee, D., H. Zhang, and C. Nguyen, 2018, "The Economic Impact of Natural Disasters in Pacific Island Countries: Adaptation and Preparedness", IMF Working Paper No. 18/108.

DEBT SUSTAINABILITY

A. External Debt Sustainability Analysis

13. Under the baseline scenario, all external PPG debt indicators remain below the policy relevant thresholds for the next ten years (Figure 1). The PV of debt-to-GDP ratio is expected to grow gradually from 4.7 percent in 2019 to 15.3 percent in 2029 due mainly to new disbursements for key infrastructure projects, including the TRHDP (Table 3). Then, it is expected to stabilize around 16.5 percent due to investment needs and large infrastructure gaps in Solomon Islands. As Figure 3 shows, the main driver of debt dynamics is a deterioration of the current account balance caused by external borrowing.

14. The standardized stress test shows that an export shock has the largest negative impact on the external debt trajectory in both baseline and customized downside scenarios.⁷ The PV of debt-to-GDP ratio permanently breaches the threshold of 40 percent by 2021 in an extreme shock to exports (Table 3). This suggests the need to expand the economy's export base, as logging activity is expected to substantially decline in the medium term. The "other flows" shock also causes a large increase in the PV of debt-to-GDP ratio, suggesting that Solomon Islands is also vulnerable to changes in donor sentiment or outflows from private sector repatriation of dividends.⁸ Other shocks, including to real GDP growth, the primary balance, and a one-time 30 percent depreciation, do not lead to a breach of any debt thresholds.

15. The tailored natural disaster shock causes all the debt trajectories for each debt indicator to move upward in the aftermath of the shock. The DSA includes a one-off shock that takes place in 2020, but there is a possibility that multiple severe natural disasters could occur within a ten-year timeframe. Staff's work shows that there is a probability of around 13.5 percent of a disaster each year of a magnitude of more than 3 percent of GDP or at least 5 percent of the population and this translates into one shock every seven years. Multiple natural disasters would evidently have a larger cumulative effect on debt sustainability through damaging long-term growth and increasing borrowing for reconstruction needs.

16. Under the customized downside growth scenario, the export shock also causes a breach of the external debt thresholds (Figure 6). The PV of debt-to-GDP ratio is expected to grow rapidly from 4.8 percent in 2019 to 22.7 percent in 2029 as new loans would be contracted to build infrastructure for the Pacific games. An export shock would cause a prolonged breach of the thresholds of both the PV of external debt-to-GDP ratio and debt-to-exports ratio from 2021 onwards.

⁷ Nominal export growth (in USD) set to its historical average minus one and a half standard deviation, or the baseline projection minus one and a half standard deviation, whichever is lower in the second and third years of the projection period.

⁸ Current transfers-to-GDP and FDI-to-GDP ratios set to their historical average minus one standard deviation, or the baseline projection minus one standard deviation, whichever is lower in the second and third years of the projection period.

B. Public Sector Debt Sustainability Analysis

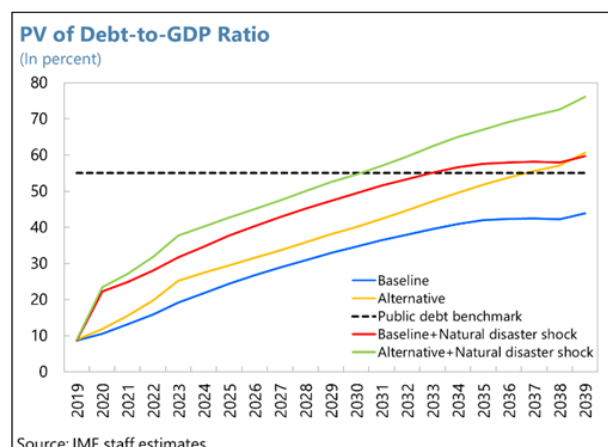
17. Public debt is currently low but rises over the medium term (Figure 2).⁹ While debt indicators remain below the indicative thresholds in staff's baseline, debt pressures significantly build up under the most extreme stress test. As Figure 3 indicates, the biggest contributor to debt creating flows is the primary deficit caused by continued expansionary fiscal policy on current spending plans. Over the long term, unless fiscal management improves substantially, the risk of an unsustainable debt ratio is high.

18. The standardized sensitivity analysis shows that the largest shock that leads to the highest debt figures in 2029 is a shock to real GDP growth (Figure 2, Table 4). The PV of the debt-to-GDP ratio would breach the threshold of 55 percent of GDP by 2025.

19. The tailored natural disaster shock results in a sharper deterioration in debt sustainability. The debt service-to-revenue ratio is expected to increase by 6 pps compared to the baseline one year after the shock and the PV of the public debt-to-GDP ratio would breach the authorities' threshold of 35 percent by 2025. This highlights the importance of rebuilding fiscal buffers against external shocks.

20. A tailored stress test for the combined contingent liability shock also causes a deterioration in debt sustainability. The trajectory of the PV of the public debt-to-GDP ratio moves upwards by 3-5 pps from the baseline. This suggests the need for the government to rebuild fiscal buffers to address the contingent liability shock.

21. Under the customized downside growth scenario, public sector debt breaches are even more pronounced. A customized downside growth scenario was constructed to assess the impact on debt sustainability of further delay in mining activity picking up, a sharper contraction of logging activities and only debt financing for the Pacific Games. In this context, debt sustainability pressures build up even more rapidly. The PV of debt-to-GDP ratio is expected to breach the indicative threshold by 2031 under the baseline (Figure 7). Since additional extreme stress tests highlight high vulnerabilities to real growth shock and natural disasters, finding new sources of growth in the medium term is much needed to ensure long-term debt sustainability.



⁹ Real GDP growth (in USD) set to its historical average minus one and a half standard deviation, or the baseline projection minus one and a half standard deviation, whichever is lower in the second and third years of the projection period.

RISK RATING AND VULNERABILITIES

22. The 2019 debt sustainability analysis under the new LIC DSF suggests that Solomon Islands' risk of external debt distress is moderate. The external risk of debt distress rating in the Solomon Islands has been maintained at moderate given the uncertainty surrounding growth prospects. Most external debt indicators remain below the relevant indicative thresholds under the baseline scenario that incorporates the average long-term effects of natural disasters on growth, the fiscal balance, and the current account balance. However, an export shock would result in a breach of the PV of external debt-to-GDP ratio. And under the customized downside scenario there are more pronounced breaches. Although debt service indicators are below their thresholds under the baseline scenarios, maximizing concessional loans would help keep the debt burden contained. The granularity in the risk rating suggests that currently there is substantial space to absorb shocks, which reflects the current low level of external debt (Figure 5).¹⁰ This space is expected to narrow over the medium-term as new borrowing comes on-stream because of the large infrastructure gap. The cut in ties with Taiwan Province of China and establishment of a diplomatic relationship with China potentially could significantly increase the availability of grants and debt financing. Staff note that Solomon Islands suffers from weak public financial management which leads to sporadic fiscal liquidity problems and these problems are exacerbated in the face of natural disasters. Also, it would be difficult for Solomon Islands to scale up rapidly and reduce the infrastructure gap without hitting absorptive capacity constraints. Solomon Islands' risk of debt distress also reflects the structural characteristics of the economy—growth is severely constrained by the country's economic geography, its distance from market, its vulnerability to external price shocks, and its exposure to natural disasters. These factors inherently limit Solomon Islands' debt carrying capacity.

23. The DSA suggests that overall risk of debt distress is moderate, reflecting the expansionary fiscal policy. A shock to real GDP growth has the largest impact on public debt sustainability, leading the PV of debt-to-GDP ratio to be above 60 percent in 2026 under the baseline scenario. These results indicate the urgent need for fiscal adjustment and measures to boost potential growth in the long run. Both tailored stress tests for natural disaster shock and the combined contingent liability shock would deteriorate debt sustainability significantly. The customized downside growth scenario further indicates the heightened vulnerability. The authorities need to embark on fiscal consolidation measures to rebuild fiscal buffers and prioritize investment projects that build resilience to natural disasters and promote economic growth.

Authorities' Views

24. The authorities broadly agreed with the debt sustainability assessment. They would seek to contain the debt sustainability risks arising from potential borrowing for the Pacific Games. They felt the staff's downside scenario was overly pessimistic since it assumed that the PG financing would be wholly loan financed. The authorities are hopeful that majority of the infrastructure projects related to PG will be grant-financed and would not contribute to debt pressure build up over the medium term.

¹⁰ The space is measured by the distance between the baseline debt burden indicators and their thresholds.

Table 1. Solomon Islands: External Debt Sustainability Framework, Baseline Scenario, 2016–39

(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/	
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029	2039	Historical	Projections
External debt (nominal) 1/	8.3	8.5	8.1	8.6	11.2	14.3	17.1	20.0	21.5	25.7	25.8	17.5	19.7
of which: public and publicly guaranteed (PPG)	7.5	7.6	7.1	7.6	10.1	13.2	15.9	18.6	20.1	24.0	23.9	12.2	17.8
Change in external debt	-2.3	0.2	-0.4	0.6	2.5	3.2	2.8	2.8	1.6	0.1	0.6		
Identified net debt-creating flows	0.4	0.7	0.8	5.0	4.3	6.5	8.8	10.5	7.9	6.1	5.0	0.2	6.4
Non-interest current account deficit	3.8	4.8	4.4	8.5	8.1	10.5	12.9	14.6	12.0	10.0	8.9	8.1	10.3
Deficit in balance of goods and services	-95.8	-99.3	-102.8	-110.6	-108.0	-106.3	-104.9	-103.9	-106.0	-83.1	-68.2	-108.2	-101.7
Exports	45.0	46.5	48.9	49.8	48.6	46.2	44.1	42.6	45.0	33.9	26.2		
Imports	-50.8	-52.8	-53.9	-60.8	-59.4	-60.1	-60.8	-61.3	-61.0	-49.2	-41.9		
Net current transfers (negative = inflow)	-5.2	-4.1	-2.7	-4.4	-4.7	-5.0	-5.3	-5.5	-5.7	-6.4	-6.9	-11.4	-5.5
of which: official	-7.1	-5.8	-4.2	-2.6	-2.5	-2.5	-2.5	-2.5	-2.5	-2.4	-2.3		
Other current account flows (negative = net inflow)	104.9	108.2	109.9	123.5	120.8	121.8	123.1	124.0	123.7	99.5	84.0	127.7	117.6
Net FDI (negative = inflow)	-2.9	-3.9	-3.1	-3.4	-3.6	-3.9	-3.9	-3.8	-3.8	-3.4	-3.6	-6.5	-3.6
Endogenous debt dynamics 2/	-0.5	-0.2	-0.5	-0.1	-0.2	-0.2	-0.2	-0.3	-0.3	-0.4	-0.4		
Contribution from nominal interest rate	0.1	0.1	0.1	0.1	0.0	0.1	0.2	0.2	0.2	0.3	0.4		
Contribution from real GDP growth	-0.3	-0.3	-0.3	-0.2	-0.2	-0.3	-0.4	-0.5	-0.5	-0.8	-0.7		
Contribution from price and exchange rate changes	-0.3	-0.1	-0.3	...	...	...	...	...	...	...	...
Residual 3/	-2.7	-0.4	-1.2	-4.4	-1.7	-3.3	-6.0	-7.7	-6.3	-6.1	-4.4	-2.7	-4.7
of which: exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	...	...	4.6	4.7	5.8	7.5	9.0	10.9	12.0	15.3	16.5		
PV of PPG external debt-to-exports ratio	...	...	9.5	9.4	11.9	16.2	20.4	25.5	26.6	45.0	63.0		
PPG debt service-to-exports ratio	1.8	1.7	1.1	1.1	0.6	0.9	1.0	1.0	1.0	2.2	3.9		
PPG debt service-to-revenue ratio	2.6	2.4	1.6	1.9	1.0	1.4	1.4	1.4	1.5	2.6	4.0		
Gross external financing need (Million of U.S. dollars)	30.9	22.4	26.8	81.0	72.6	112.4	158.5	201.2	166.4	199.2	355.1		
Key macroeconomic assumptions													
Real GDP growth (in percent)	3.2	3.7	3.9	2.7	2.5	2.7	2.8	2.8	2.9	3.3	3.2	3.8	2.8
GDP deflator in US dollar terms (change in percent)	3.1	0.6	3.9	-0.3	2.4	3.0	3.4	3.7	4.0	3.9	4.7	4.8	3.2
Effective interest rate (percent) 4/	1.3	1.5	1.2	1.5	-0.3	1.2	1.2	1.2	1.3	1.4	1.7	2.1	1.2
Growth of exports of G&S (US dollar terms, in percent)	5.3	7.8	13.5	4.3	2.4	0.6	1.5	2.9	13.1	-0.5	8.5	11.9	3.1
Growth of imports of G&S (US dollar terms, in percent)	1.0	8.5	10.0	15.5	2.6	7.1	7.5	7.5	6.4	2.3	9.6	8.0	5.7
Grant element of new public sector borrowing (in percent)	...	...	...	62.0	55.2	46.6	45.8	40.0	40.4	41.8	33.0	...	46.1
Government revenues (excluding grants, in percent of GDP)	31.8	32.8	34.3	30.1	29.8	29.6	29.5	29.2	29.1	28.1	25.7	32.6	29.2
Aid flows (in Million of US dollars) 5/	230.3	231.9	249.7	127.9	132.3	141.8	159.9	192.8	180.8	222.1	397.3		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	9.6	8.5	9.0	9.5	10.7	9.4	8.0	7.6	...	9.0
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	95.3	85.6	80.9	82.2	81.6	84.1	86.6	78.7	...	84.8
Nominal GDP (Million of US dollars)	1,233	1,287	1,388	1,421	1,492	1,579	1,678	1,789	1,913	2,689	5,497		
Nominal dollar GDP growth	6.4	4.4	7.9	2.4	5.0	5.8	6.3	6.6	7.0	7.3	8.1	9.1	6.1
Memorandum items:													
PV of external debt 7/	...	...	5.5	5.7	6.9	8.6	10.3	12.2	13.4	16.9	18.5		
In percent of exports	...	...	11.3	11.4	14.2	18.7	23.3	28.6	29.8	50.0	70.4		
Total external debt service-to-exports ratio	3.6	1.9	1.3	1.3	0.8	1.0	1.1	1.1	1.1	2.4	4.3		
PV of PPG external debt (in Million of US dollars)	...	...	64.3	66.2	86.5	117.8	150.9	194.2	229.3	410.1	908.4		
(PVt-PVt-1)/GDPt-1 (in percent)	...	...	0.1	1.4	2.1	2.1	2.6	2.0	1.3	1.9	1.9		
Non-interest current account deficit that stabilizes debt ratio	6.2	4.5	4.8	7.9	5.5	7.4	10.1	11.7	10.4	9.9	8.3		

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

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

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

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

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

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

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

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

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

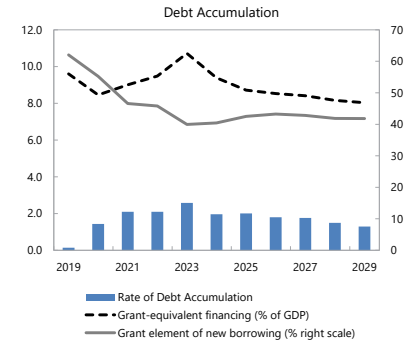
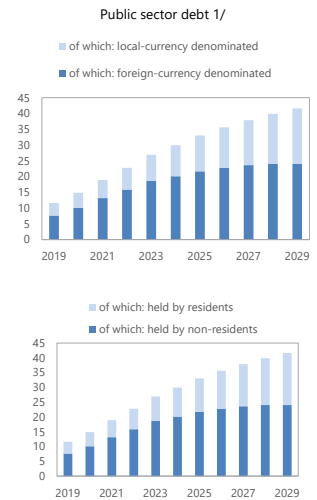


Table 2. Solomon Islands: Public Sector Debt Sustainability Framework, Baseline Scenario, 2016-39
(In percent of GDP, unless otherwise indicated)

	Actual			Projections										Average 6/	
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029	2039	Historical	Projections		
Public sector debt 1/	7.9	9.5	9.4	11.6	14.9	18.9	22.8	26.9	29.9	41.6	51.3	16.4	28.5		
of which: external debt	7.5	7.6	7.1	7.6	10.1	13.2	15.9	18.6	20.1	24.0	23.9	12.2	18.3		
Change in public sector debt	-2.2	1.6	-0.1	2.3	3.2	4.1	3.9	4.1	3.0	1.8	1.7				
Identified debt-creating flows	3.4	3.7	-1.2	2.3	3.2	4.2	4.1	4.4	3.4	2.3	2.4	-3.8	3.3		
Primary deficit	3.8	4.3	-0.9	2.5	3.6	4.5	4.5	5.0	4.1	3.3	3.5	-2.2	3.9		
Revenue and grants	43.2	43.1	45.3	39.0	36.5	36.7	37.2	38.3	37.3	35.3	32.3	50.6	36.7		
of which: grants	11.4	10.2	11.0	8.8	6.7	7.2	7.7	9.1	8.2	7.1	6.6				
Primary (noninterest) expenditure	47.0	47.4	44.4	41.5	40.1	41.2	41.7	43.4	41.4	38.6	35.8	48.4	40.6		
Automatic debt dynamics	-0.4	-0.6	-0.3	-0.2	-0.3	-0.3	-0.5	-0.6	-0.7	-1.0	-1.1				
Contribution from interest rate/growth differential	-0.4	-0.3	-0.4	-0.2	-0.3	-0.3	-0.5	-0.6	-0.7	-1.0	-1.1				
of which: contribution from average real interest rate	0.0	0.0	0.0	0.0	-0.1	0.1	0.1	0.1	0.1	0.3	0.4				
of which: contribution from real GDP growth	-0.3	-0.3	-0.4	-0.2	-0.3	-0.4	-0.5	-0.6	-0.8	-1.3	-1.5				
Contribution from real exchange rate depreciation	0.0	-0.3	0.1	...	...	...	...	...	...	...	...
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	0.0		
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0				
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0				
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0				
Other debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0				
Residual	-5.7	-2.2	1.1	0.0	0.0	-0.1	-0.2	-0.3	-0.4	-0.6	-0.7	1.2	-0.3		
Sustainability indicators															
PV of public debt-to-GDP ratio 2/	...	...	6.9	8.7	10.6	13.2	15.9	19.2	21.8	32.9	43.9		
PV of public debt-to-revenue and grants ratio	...	...	15.3	22.2	29.0	35.9	42.8	49.9	58.5	93.1	136.0		
Debt service-to-revenue and grants ratio 3/	3.0	2.9	2.3	3.2	2.7	3.2	3.5	3.7	4.2	5.7	8.6				
Gross financing need 4/	5.0	5.4	0.1	3.7	4.6	5.7	5.8	6.4	5.7	5.3	6.3				
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	3.2	3.7	3.9	2.7	2.5	2.7	2.8	2.8	2.9	3.3	3.2	3.8	2.9		
Average nominal interest rate on external debt (in percent)	1.0	1.2	0.8	1.0	-1.0	0.8	0.9	0.9	1.0	1.2	1.4	1.1	0.9		
Average real interest rate on domestic debt (in percent)	-0.7	-0.3	-0.8	-0.5	-2.5	-0.7	-0.7	-0.6	-0.5	-0.4	-0.2	-0.3	-0.7		
Real exchange rate depreciation (in percent, + indicates depreciation)	-0.3	-4.4	1.5	...	...	...	...	...	...	...	...	-3.0	...
Inflation rate (GDP deflator, in percent)	3.7	1.9	3.5	1.4	2.4	3.0	3.4	3.7	4.0	3.9	4.7	5.1	3.4		
Growth of real primary spending (deflated by GDP deflator, in percent)	2.2	4.5	-2.8	-4.1	-0.9	5.7	4.0	6.8	-1.8	2.3	2.8	3.7	1.6		
Primary deficit that stabilizes the debt-to-GDP ratio 5/	6.1	2.8	-0.8	0.2	0.3	0.4	0.7	0.9	1.1	1.5	1.8	2.7	1.0		
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0				

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



Sources: Country authorities; and staff estimates and projections.

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

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

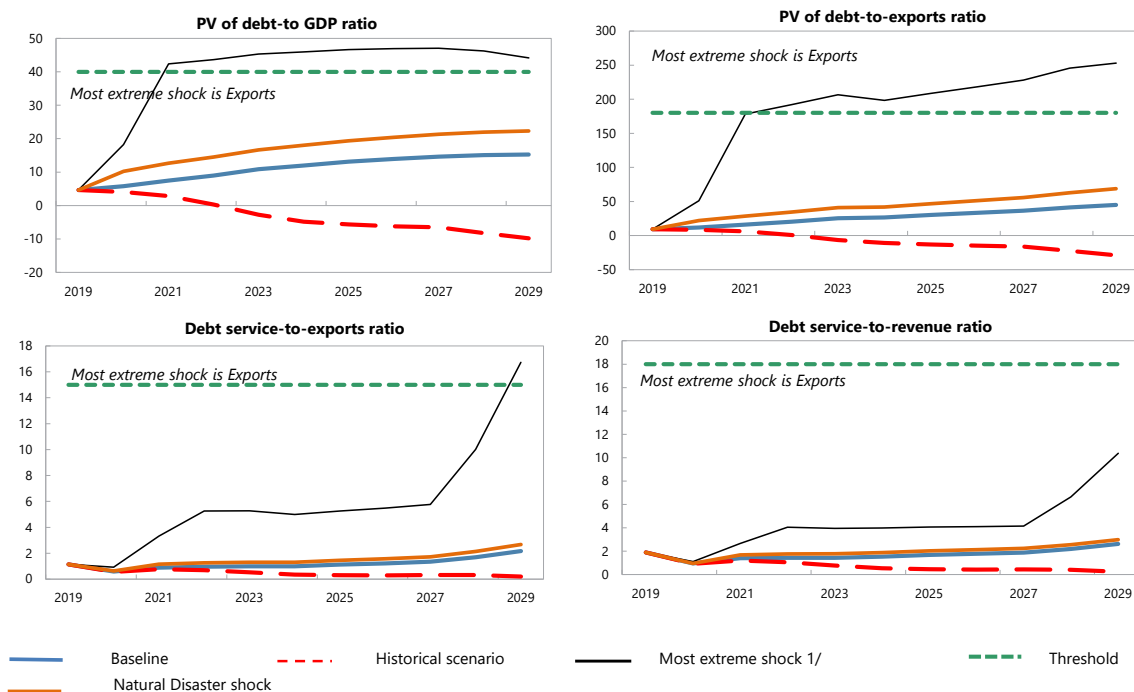
3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.

4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.

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

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

Figure 1. Solomon Islands: Indicators of Public and Publicly Guaranteed External Debt Under Baseline Scenario, 2019–29 1/



Customization of Default Settings		
	Size	Interactions
Standardized Tests	Yes	
Tailored Tests		
Combined CLs	Yes	
Natural Disasters	Yes	Yes
Commodity Prices ^{2/}	n.a.	n.a.
Market Financing	n.a.	n.a.

Borrowing Assumptions for Stress Tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	1.2%	1.2%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	29	29
Avg. grace period	7	7

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

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

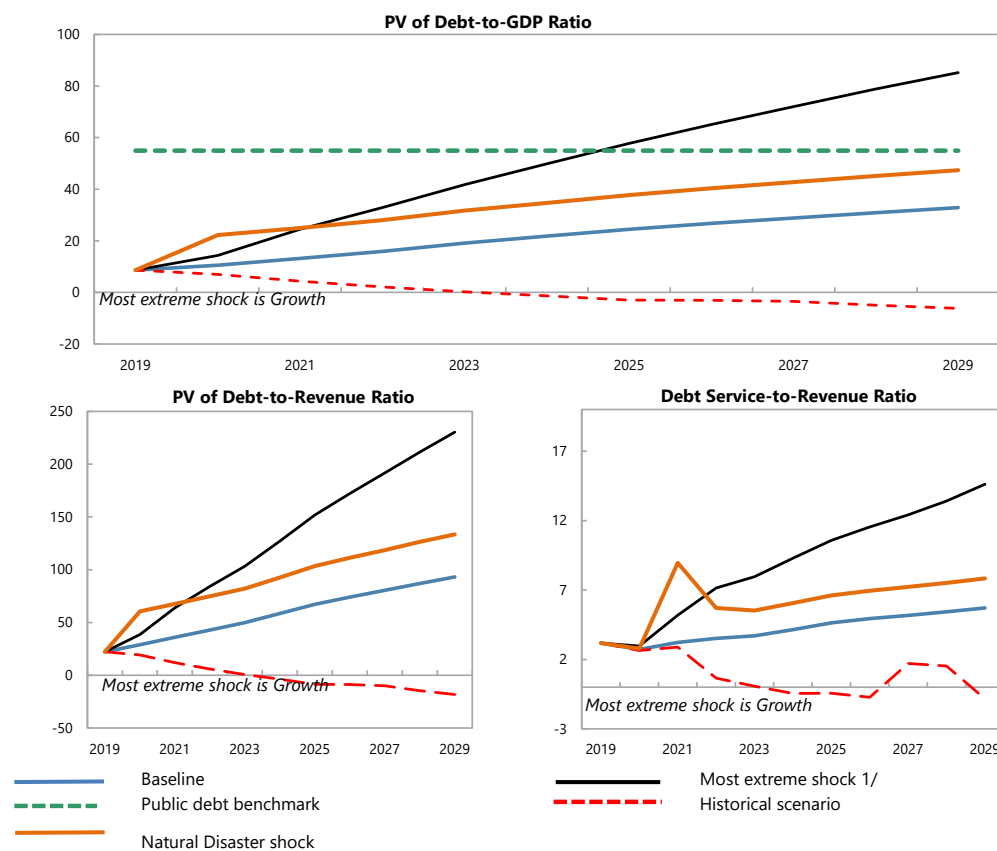
Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. Stress tests with one-off breaches are also presented (if any), while these one-off breaches are deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the

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

Figure 2. Solomon Islands: Indicators of Public Debt Under Alternative Scenarios, 2019–29 1/

Figure 2. Solomon Islands: Indicators of Public Debt Under Alternative Scenarios, 2019-2029



Borrowing Assumptions for Stress Tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	52%	52%
Domestic medium and long-term	36%	36%
Domestic short-term	9%	12%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	1.2%	1.2%
Avg. maturity (incl. grace period)	29	29
Avg. grace period	7	7
Domestic MLT debt		
Avg. real interest rate on new borrowing	3.1%	3.1%
Avg. maturity (incl. grace period)	15	15
Avg. grace period	14	14
Domestic short-term debt		
Avg. real interest rate	-2%	-2%

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

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Table 3. Solomon Islands: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2019–29
(In percent)

	Projections 1/										
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
PV of debt-to-GDP ratio											
Baseline	4.7	5.8	7.5	9.0	10.9	12.0	13.1	13.9	14.6	15.1	15.3
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	4.7	4.1	2.8	0.3	-2.7	-4.9	-5.6	-6.2	-6.5	-8.2	-9.8
B. Bound Tests											
B1. Real GDP growth	4.7	6.5	9.2	11.1	13.4	14.8	16.2	17.2	18.1	18.6	18.9
B2. Primary balance	4.7	7.0	10.0	11.7	13.6	14.7	15.8	16.7	17.3	17.7	17.8
B3. Exports	4.7	18.2	42.4	43.7	45.3	45.9	46.6	46.9	47.0	46.3	44.2
B4. Other flows 3/	4.7	14.1	23.9	25.1	26.6	27.3	28.0	28.5	28.8	28.4	27.5
B6. One-time 30 percent nominal depreciation	4.7	7.3	23.2	24.9	26.9	28.0	29.1	29.8	30.3	30.6	29.8
B6. Combination of B1-B5	4.7	17.3	37.2	38.5	40.1	40.8	41.5	41.8	42.0	41.4	39.6
C. Tailored Tests											
C1. Combined contingent liabilities	4.7	7.6	9.5	11.0	12.9	14.0	15.1	15.9	16.6	17.0	17.2
C2. Natural disaster	4.7	10.2	12.6	14.5	16.7	18.0	19.4	20.4	21.3	22.0	22.3
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	40	40	40	40	40	40	40	40	40	40	40
PV of debt-to-exports ratio											
Baseline	9.4	11.9	16.2	20.4	25.5	26.6	30.2	33.3	36.5	41.2	45.0
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	9.4	8.3	6.2	0.7	-6.4	-10.8	-12.9	-14.8	-16.3	-22.5	-28.9
B. Bound Tests											
B1. Real GDP growth	9.4	11.9	16.2	20.4	25.5	26.6	30.2	33.3	36.5	41.2	45.0
B2. Primary balance	9.4	14.4	21.7	26.6	31.9	32.7	36.5	39.8	43.3	48.5	52.5
B3. Exports	9.4	51.1	178.2	192.3	206.7	198.3	208.7	218.2	228.0	245.8	253.2
B4. Other flows 3/	9.4	29.0	51.7	56.8	62.4	60.6	64.5	68.1	71.8	77.8	81.0
B6. One-time 30 percent nominal depreciation	9.4	11.9	40.0	44.8	50.2	49.4	53.2	56.6	60.2	66.5	69.9
B6. Combination of B1-B5	9.4	37.7	66.2	107.7	116.2	111.8	117.9	123.5	129.3	139.6	144.2
C. Tailored Tests											
C1. Combined contingent liabilities	9.4	15.7	20.5	25.0	30.3	31.1	34.8	38.1	41.5	46.6	50.7
C2. Natural disaster	9.4	22.1	28.7	34.5	41.0	41.9	46.7	51.2	55.7	62.9	68.9
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	180	180	180	180	180	180	180	180	180	180	180
Debt service-to-exports ratio											
Baseline	1.1	0.6	0.9	1.0	1.0	1.0	1.1	1.2	1.3	1.7	2.2
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	1.1	0.6	0.8	0.7	0.5	0.4	0.3	0.3	0.3	0.3	0.2
B. Bound Tests											
B1. Real GDP growth	1.1	0.6	0.9	1.0	1.0	1.0	1.1	1.2	1.3	1.7	2.2
B2. Primary balance	1.1	0.6	0.9	1.1	1.1	1.1	1.2	1.3	1.5	2.0	2.7
B3. Exports	1.1	0.9	3.3	5.3	5.3	5.0	5.3	5.5	5.8	10.0	16.7
B4. Other flows 3/	1.1	0.6	1.3	1.7	1.7	1.6	1.8	1.8	2.0	3.4	5.1
B6. One-time 30 percent nominal depreciation	1.1	0.6	0.9	1.5	1.5	1.4	1.6	1.6	1.8	2.1	4.2
B6. Combination of B1-B5	1.1	0.7	1.9	3.0	3.0	2.9	3.0	3.2	3.3	5.7	9.4
C. Tailored Tests											
C1. Combined contingent liabilities	1.1	0.6	1.0	1.1	1.1	1.1	1.2	1.3	1.4	1.8	2.3
C2. Natural disaster	1.1	0.6	1.2	1.3	1.3	1.3	1.5	1.6	1.7	2.1	2.7
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	15	15	15	15	15	15	15	15	15	15	15
Debt service-to-revenue ratio											
Baseline	1.9	1.0	1.4	1.4	1.4	1.5	1.7	1.8	1.9	2.2	2.6
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	1.9	0.9	1.2	1.1	0.8	0.5	0.5	0.4	0.4	0.4	0.2
B. Bound Tests											
B1. Real GDP growth	1.9	1.1	1.7	1.8	1.8	1.9	2.1	2.2	2.3	2.7	3.2
B2. Primary balance	1.9	1.0	1.5	1.6	1.6	1.7	1.9	1.9	2.1	2.6	3.2
B3. Exports	1.9	1.1	2.7	4.1	4.0	4.0	4.1	4.1	4.2	6.6	10.4
B4. Other flows 3/	1.9	1.0	2.0	2.5	2.5	2.5	2.6	2.7	2.7	4.4	6.1
B6. One-time 30 percent nominal depreciation	1.9	1.2	1.8	2.8	2.7	2.8	2.9	3.0	3.1	3.5	6.3
B6. Combination of B1-B5	1.9	1.1	2.5	3.6	3.6	3.6	3.7	3.7	3.8	6.0	9.2
C. Tailored Tests											
C1. Combined contingent liabilities	1.9	1.0	1.5	1.6	1.6	1.7	1.8	1.9	2.0	2.3	2.7
C2. Natural disaster	1.9	1.0	1.7	1.8	1.8	1.9	2.0	2.1	2.3	2.6	3.0
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	18	18	18	18	18	18	18	18	18	18	18

Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the threshold.

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

3/ Includes official and private transfers and FDI.

Table 4. Solomon Islands: Sensitivity Analysis for Key Indicators of Public Debt 2019–29
(In percent)

	Projections 1/										
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
PV of Debt-to-GDP Ratio											
Baseline	8.7	10.6	13.2	15.9	19.2	21.8	24.4	26.7	28.9	30.9	32.9
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	8.7	7.0	4.4	2.2	0.3	-1.4	-3.0	-3.0	-3.4	-4.9	-6.2
B. Bound Tests											
B1. Real GDP growth	8.7	14.3	24.5	32.9	41.8	49.8	57.8	65.1	72.1	78.8	85.2
B2. Primary balance	8.7	13.8	19.5	22.0	25.1	27.7	30.2	32.4	34.4	36.4	38.2
B3. Exports	8.7	20.5	38.6	40.8	43.4	45.4	47.5	49.2	50.7	51.7	51.9
B4. Other flows 3/	8.7	18.8	29.6	32.0	34.8	37.1	39.3	41.3	43.0	44.3	45.1
B6. One-time 30 percent nominal depreciation	8.7	9.9	10.6	11.5	13.1	14.3	15.5	16.5	17.4	18.3	19.3
B6. Combination of B1-B5	8.7	12.6	15.5	17.0	20.5	23.4	26.3	28.9	31.4	33.7	35.9
C. Tailored Tests											
C1. Combined contingent liabilities	8.7	15.4	17.8	20.4	23.5	26.1	28.7	30.9	32.9	34.9	36.7
C2. Natural disaster	8.7	22.2	24.9	28.0	31.7	34.7	37.7	40.4	42.8	45.2	47.4
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Public debt benchmark	55	55	55	55	55	55	55	55	55	55	55
PV of Debt-to-Revenue Ratio											
Baseline	22.2	29.0	35.9	42.8	49.9	58.5	67.3	74.1	80.4	87.0	93.1
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	22.2	19.3	12.1	5.9	0.7	-3.7	-8.5	-8.7	-9.9	-14.5	-18.3
B. Bound Tests											
B1. Real GDP growth	22.2	38.5	63.7	84.2	103.2	127.1	151.7	172.1	191.6	211.5	230.4
B2. Primary balance	22.2	37.7	52.9	59.0	65.5	74.2	83.2	89.8	95.9	102.3	108.2
B3. Exports	22.2	56.3	105.0	109.6	113.3	122.0	130.8	136.3	141.3	145.5	147.0
B4. Other flows 3/	22.2	51.6	80.6	85.9	90.9	99.5	108.3	114.3	119.8	124.5	127.7
B6. One-time 30 percent nominal depreciation	22.2	27.5	29.4	31.5	34.7	39.0	43.3	46.3	49.1	52.4	55.5
B6. Combination of B1-B5	22.2	34.5	41.9	45.3	53.1	62.5	72.2	79.8	87.0	94.3	101.1
C. Tailored Tests											
C1. Combined contingent liabilities	22.2	42.1	48.3	54.8	61.4	70.1	78.9	85.5	91.7	98.1	104.1
C2. Natural disaster	22.2	60.6	67.5	75.0	82.2	92.7	103.4	111.3	118.7	126.4	133.5
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Debt Service-to-Revenue Ratio											
Baseline	3.2	2.7	3.2	3.5	3.7	4.2	4.6	4.9	5.2	5.4	5.7
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	3.2	2.6	2.9	0.7	0.1	-0.5	-0.4	-0.7	1.7	1.5	-0.8
B. Bound Tests											
B1. Real GDP growth	3.2	3.0	5.2	7.2	8.0	9.3	10.6	11.5	12.4	13.4	14.6
B2. Primary balance	3.2	2.7	4.9	5.7	4.7	5.0	5.5	5.8	6.0	6.4	6.8
B3. Exports	3.2	2.7	3.8	4.9	4.9	5.4	5.8	6.1	6.2	7.8	10.0
B4. Other flows 3/	3.2	2.7	3.7	4.4	4.5	4.9	5.4	5.7	5.9	7.2	8.5
B6. One-time 30 percent nominal depreciation	3.2	2.7	3.4	3.6	3.6	4.0	4.4	4.7	4.8	4.8	4.9
B6. Combination of B1-B5	3.2	2.7	3.3	3.6	3.9	4.5	5.1	5.4	5.7	6.0	6.4
C. Tailored Tests											
C1. Combined contingent liabilities	3.2	2.7	5.6	4.3	4.3	4.7	5.2	5.5	5.7	6.0	6.2
C2. Natural disaster	3.2	2.8	9.0	5.7	5.5	6.1	6.6	7.0	7.2	7.5	7.8
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

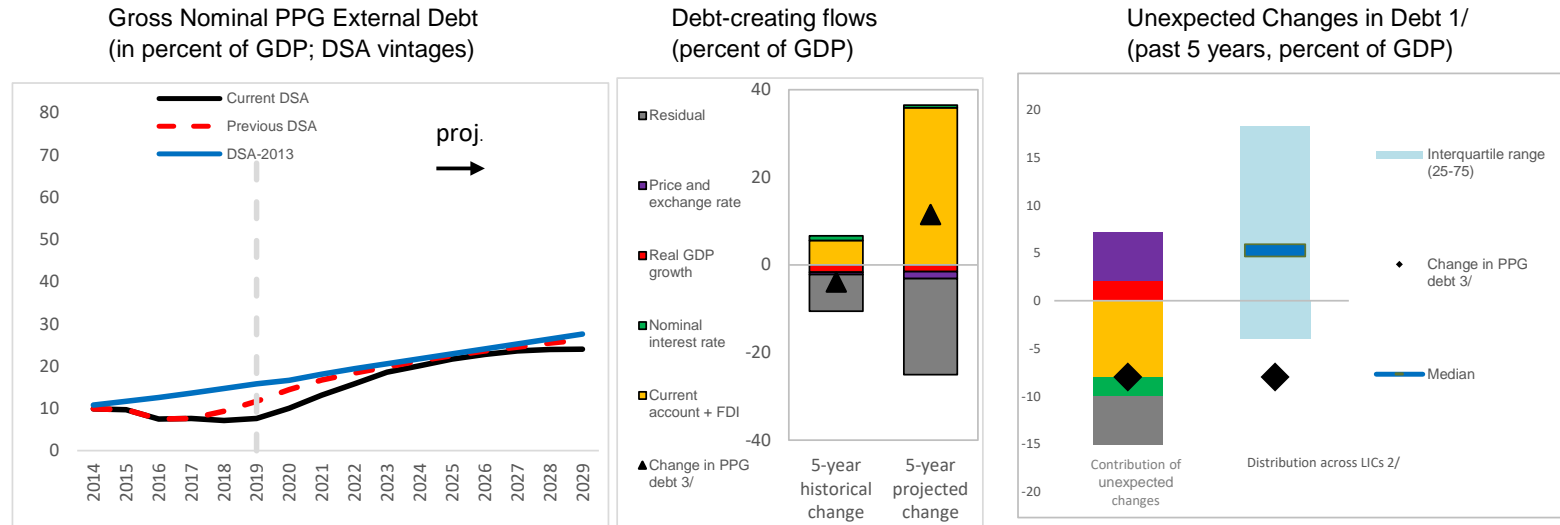
Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the threshold.

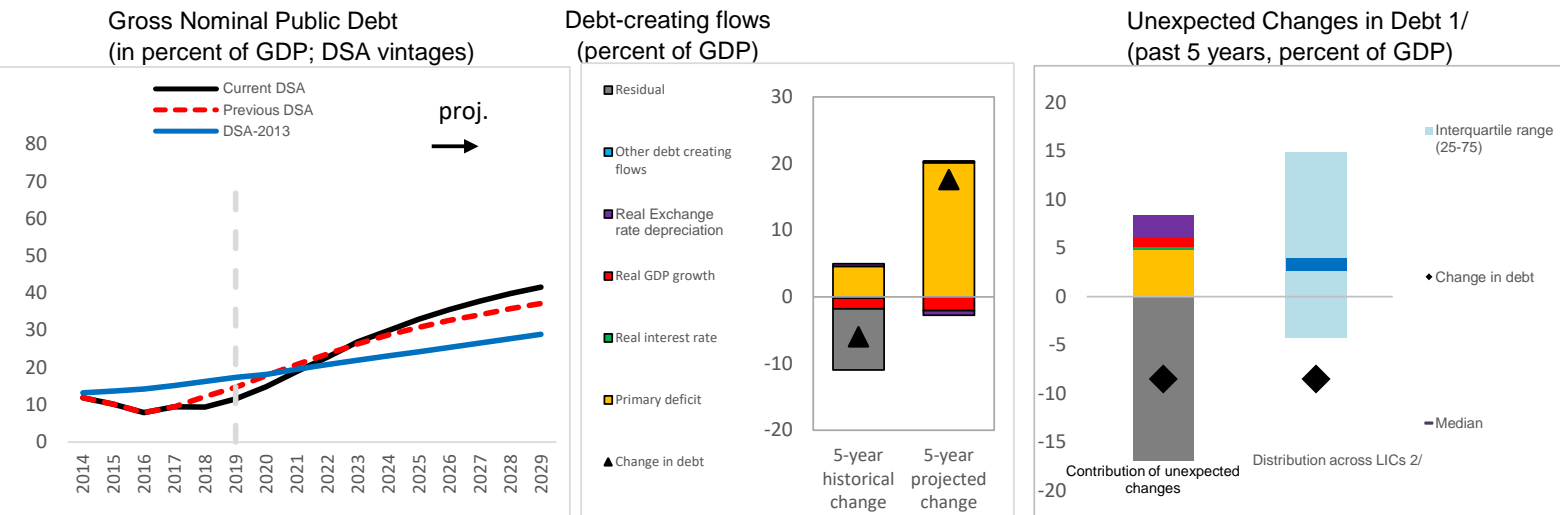
2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.

3/ Includes official and private transfers and FDI.

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



Public Debt



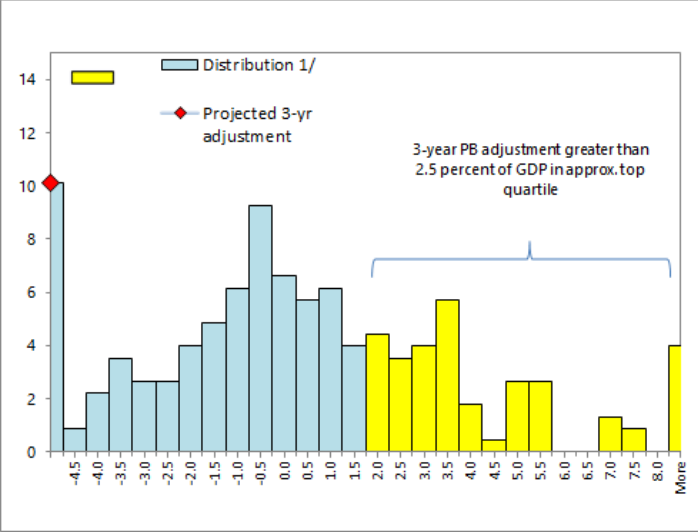
1/ Difference between anticipated and actual contributions on debt ratios.

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

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

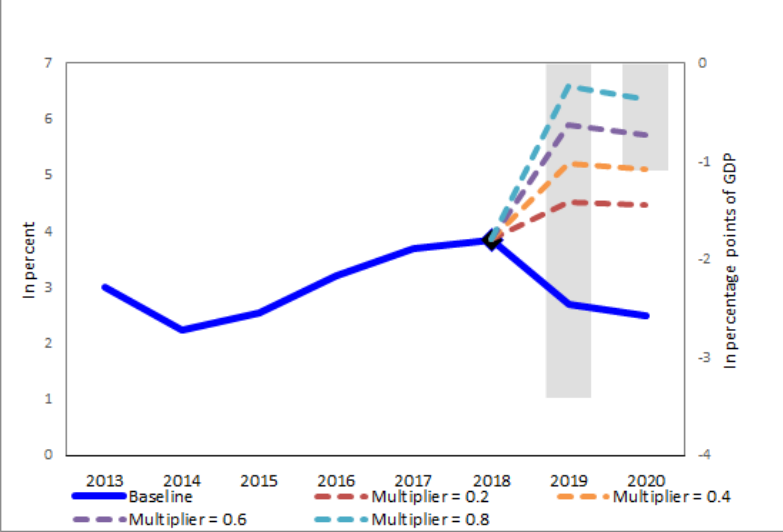
Figure 4. Solomon Islands: Realism tools

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



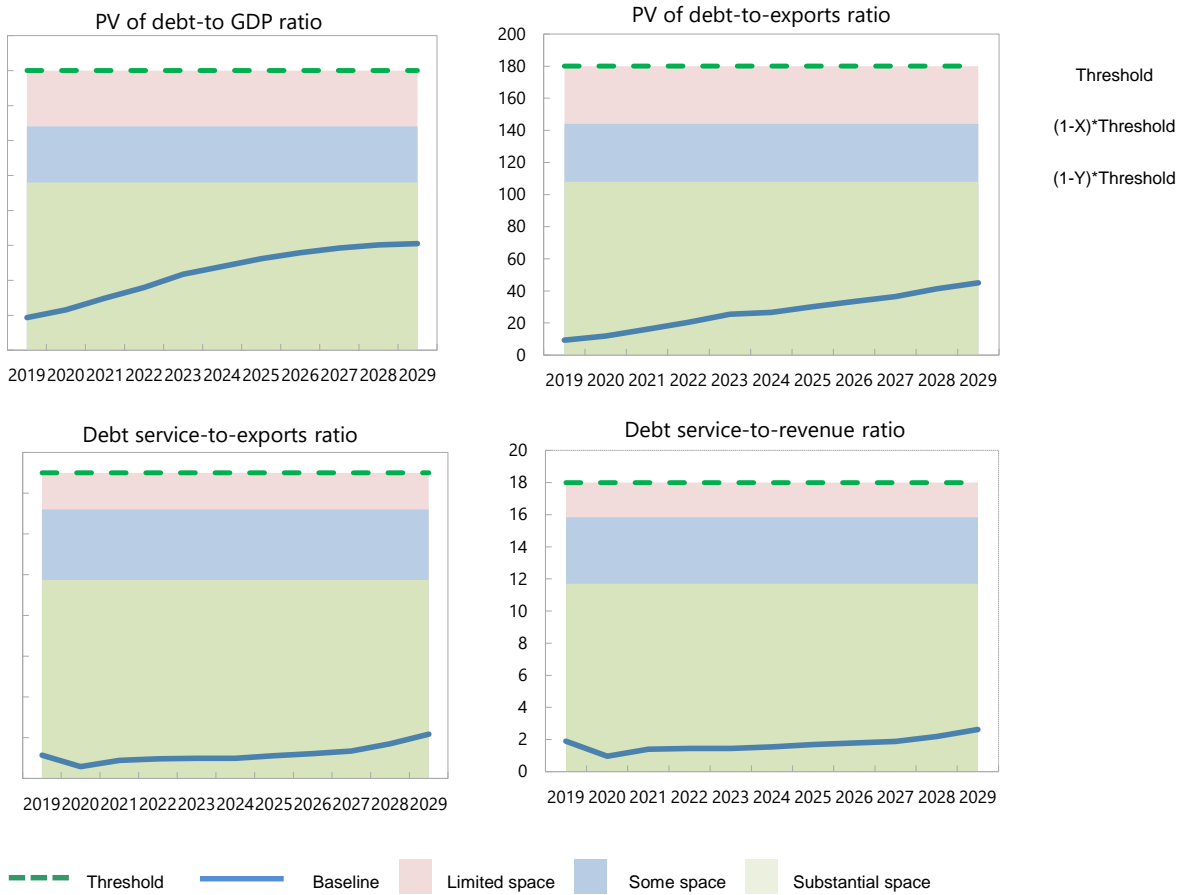
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



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

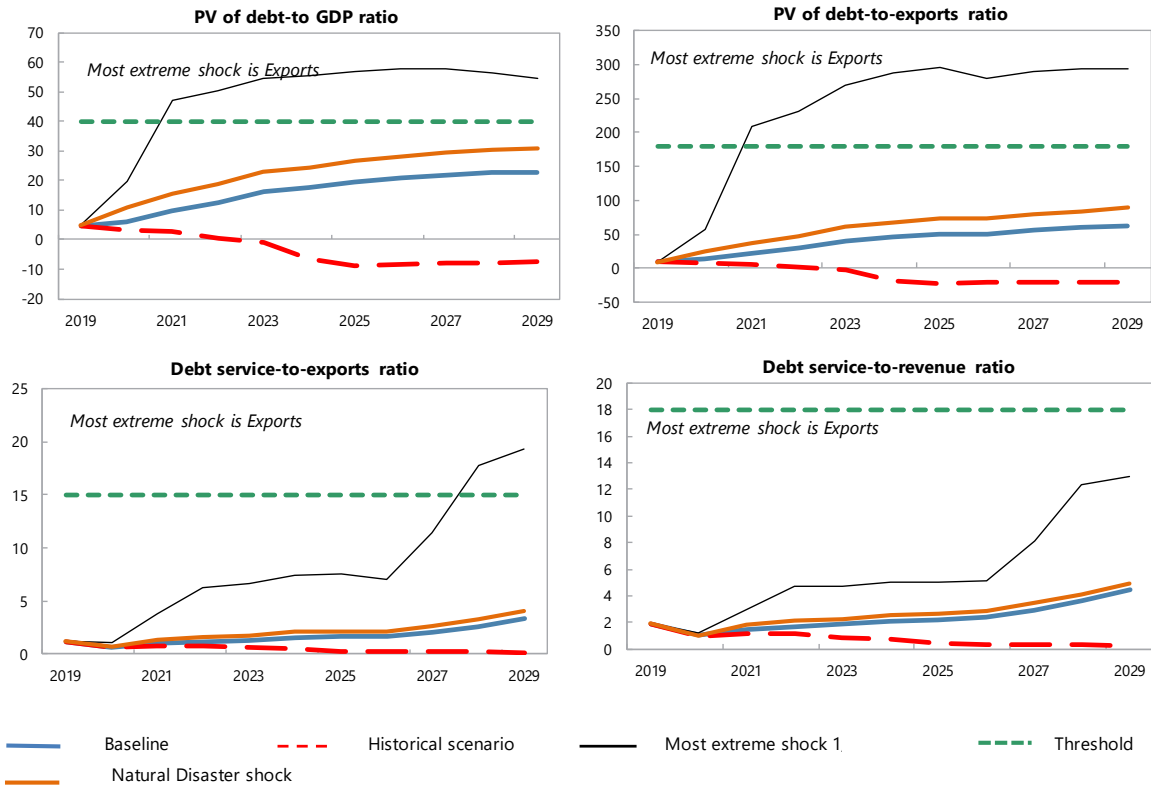
Figure 5. Solomon Islands: Qualification of the Moderate Category, 2019–29 1/



Sources: Country authorities; and staff estimates and projections.

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

Figure 6. Solomon Islands: Customized Downside Scenario: Indicators of External Debt Under Alternative Scenarios, 2019–29 1/



Customization of Default Settings		
	Size	Interactions
Standardized Tests	Yes	
Tailored Tests		
Combined CLs	Yes	
Natural Disasters	Yes	Yes
Commodity Prices ^{2/}	n.a.	n.a.
Market Financing	n.a.	n.a.

Borrowing Assumptions for Stress Tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	1.3%	1.3%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	29	29
Avg. grace period	7	6

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

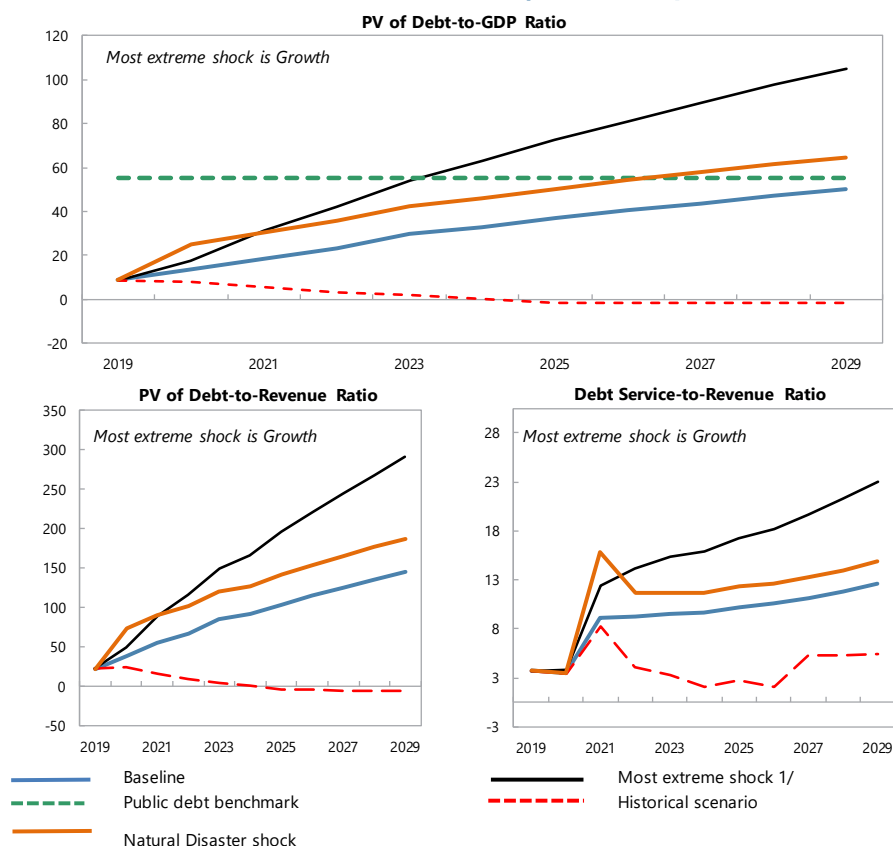
* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. Stress tests with one-off breaches are also presented (if any), while these one-off breaches are deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

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

Figure 7. Solomon Islands: Customized Downside Scenario: Indicators of Public Debt Under Alternative Scenarios, 2019–29 1/



Borrowing Assumptions for Stress Tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	53%	56%
Domestic medium and long-term	38%	31%
Domestic short-term	23%	13%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	1.3%	1.4%
Avg. maturity (incl. grace period)	29	30
Avg. grace period	7	6
Domestic MLT debt		
Avg. real interest rate on new borrowing	3.1%	3.1%
Avg. maturity (incl. grace period)	15	15
Avg. grace period	14	14
Domestic short-term debt		
Avg. real interest rate	-2%	-2%

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

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

**Statement by Nigel Ray, Executive Director for Solomon Islands
and Laura Johnson, Senior Advisor to Executive Director
February 5, 2020**

The Solomon Islands is a low-income country of around 650,000 people, speaking over 120 languages, across some 900 islands in the South Pacific. The Solomon Islands has a total land area of about 28,400 square kilometers spread over 1.34 million square kilometers of ocean – an area larger than France, Germany and Poland combined. Its dispersed population, large infrastructure needs, narrow economic base, and exposure to natural disasters and commodity price volatilities pose many development challenges. The authorities are aware of the macroeconomic risks the country faces and appreciate the analysis, advice and technical assistance provided by the Fund.

Economic outlook

The authorities note that preliminary data suggest that economic growth has slowed further than staff's expected 2.7 percent in 2019 owing to weak performances from commodities combined with subdued domestic demand. The forestry sector declined as a result of weak demand for logs from China. Uncertainties emanating from the national elections in April and the newly elected government's decision to switch ties from the Taiwan Province of China to China eroded business confidence and weakened domestic demand. Over the medium term, staff estimate growth to average around 2.7 percent with growth expected to be supported by infrastructure spending and mining activity that is expected to commence in late 2020. Inflation remains within the target range of 2 to 4 percent. Foreign reserves are equivalent to 8.1 months of imports.

The authorities agreed with the overall economic assessment. They are aware that the economy may be transitioning away from the logging sector with consequential effects on export earnings, employment, government revenue and overall demand. Diversification is a challenge for the authorities and more granular advice from staff on how to adjust would be welcome. An inter-agency committee has been established to develop a logging sustainability policy to be implemented in 2020. The mining sector has been identified as one of the main potential growth drivers over the medium term and the authorities collaborated with one of the development partners to improve the legislative framework. The expected reopening of the Gold Ridge Mine and major infrastructure projects will support growth in the next few years. These projects – including the undersea cable and the Tina River Hydro Project – will also help to improve business conditions and improve productivity in the long term.

Fiscal policy

Budget pressures resurfaced in 2019. Revenue underperformance, of around 5 percent in the first six months, reflected broad-based declines across major revenue categories most notably log export duties, import duties and corporate income tax.

Stabilizing public finances remains a priority for the government, but the general election in early 2019 interrupted progress on fiscal consolidation. The authorities are maintaining their efforts to strengthen tax compliance, to progress tax reform – including indirect tax reform, and to tighten expenditure controls and procurement processes at the Ministry of Finance and Treasury.

The authorities are committed to the current debt management framework which has been in place since 2012. Given the country's large infrastructure needs, the authorities are working closely with development partners, including China, to address these needs. On the preparation for the 2023 Pacific Games, the authorities are negotiating grant financing from bilateral development partners for the investments required, but are prepared to borrow if necessary, within the bounds of the debt management framework.

Monetary and financial sector policies

The Central Bank of Solomon Islands will continue an accommodative monetary policy stance in view of the low inflation environment, the weak growth outlook and slowing credit growth. The authorities consider that the basket exchange rate peg remains an appropriate nominal anchor for Solomon Islands.

There remains structural excess liquidity in the banking system, reflecting limited demand for credit. The authorities acknowledge the staff advice around the options to reduce structural excess liquidity over time, including facilitating further offshore investment by the National Provident Fund. But with contained credit growth and low inflation, the authorities prefer a more gradual approach to avoid putting any unnecessary pressure on domestic banks.

The banking sector remains well-capitalized and profitable, in a shallow and under-developed market. Interest rates on lending remain exceptionally high, as do ATM fees, and the authorities are working with the banks (both foreign and local) to understand the drivers. A correspondent banking relationship has been established between the one local bank and its overseas counterpart for a period of three years from January 2019, which has reduced financial stability risks.

Given the temporary nature of the correspondent banking arrangement, the Central Bank is urging the local bank to ensure bank processes comply with the overseas bank requirements and for the local bank to provide regular updates to the supervision department. Additionally, the authorities are continuing to encourage the local bank to establish alternative correspondent banking relationships in non-USD currencies.

The authorities are continuing to implement a number of measures to foster financial inclusion. The next financial inclusion strategy plan from 2020 will shift focus to green finance to build climate change resilience and the authorities remain committed to mainstreaming financial literacy in the school curriculum.

Natural disaster resilience

Solomon Islands faces many natural disasters, including tropical cyclones, drought, earthquake, tsunami and flood. Disasters could occur with higher frequency and severity owing to climate change and global warming. In any year, there is a one in seven chance that the Solomon Islands will face a severe natural disaster.

The National Development Strategy released in January 2015 envisages higher investment in climate and natural disaster proof infrastructure. But the weak fiscal position hampers the ability for the authorities to prepare for a major natural disaster.

As a country that is highly vulnerable to climate change and exposed to shocks from high frequency of natural disasters, the authorities are pleased that the Debt Sustainability Analysis continues to take account of these factors. They acknowledge the importance of rebuilding fiscal buffers to respond to natural disasters and to undertake infrastructure investments to increase resilience.

Technical Assistance

The authorities highly value the capacity development and technical assistance provided by the Fund. In this regard, they very much welcome the addition of Annex 1 to the staff report, which highlights priority areas for technical assistance.

The authorities welcome continuing technical assistance on public financial management, cash flow management, and assistance to develop a medium-term revenue strategy, which should boost revenue collections from both tax and non-tax categories.

Given the weak monetary policy transmission channels, the authorities have also sought additional technical assistance for the development of a monetary policy framework while expressing an interest in follow-up technical assistance on reserve and exchange rate management and/or transfer pricing in the mining sector.

While the authorities highly value the assistance provided by the Fund, they encourage further efforts to coordinate technical assistance across development partners given capacity constraints. They are interested in knowing whether Annex 1 could be expanded to capture assistance provided by other partners such as the World Bank or OECD. The authorities consider that technical assistance at the operational level would also be very valuable as it would greatly enhance knowledge transfer and enhance the authorities' capacity to implement recommendations.

The authorities thank the Fund for their advice and ongoing technical assistance and look forward to further constructive engagement in the future.