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Solomon Islands: 2005 Article IV Consultation—Staff Report; and Public Information Notice on the Executive Board Discussion

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 2005 Article IV consultation with the Solomon Islands, the following documents have been released and are included in this package:

- the staff report for the 2005 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on July 12, 2005, 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 September 13, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) updating information on recent developments and summarizing the views of the Executive Board as expressed during its September 28, 2005 discussion of the staff report that concluded the Article IV consultation.

The document listed below will be separately released.

Selected Issues and Statistical Appendix paper

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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SOLOMON ISLANDS

Staff Report for the 2005 Article IV Consultation

Prepared by the Staff Representatives for
the 2005 Consultation with the Solomon Islands

Approved by Steven Dunaway and Michael Hadjimichael

September 13, 2005

- The 2005 Article IV Consultation discussions were held in Honiara during June 30–July 12. The team comprised Ms. Papi (head), Messrs. Ginting and Porter (all APD). Mr. Francis (OED) attended the policy meetings.
- The team met with Deputy Prime Minister Rini, Finance Minister Boyers, Governor Houenipwela of the Central Bank of the Solomon Islands (CBSI), other senior government officials, donors, and private sector representatives.
- The Solomon Islands accepted the obligations of Article VIII, Sections 2(a), 3, and 4 in 1979. Exchange restrictions reintroduced starting in 2000 were removed in 2003. The Solomon Islands now maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.
- While improving, data quality, coverage, and timeliness remain weak, hampering surveillance.
- As last year, the authorities indicated their intention to publish the Article IV documents.

Contents Page

EXECUTIVE SUMMARY

Economic Developments and Challenges

The improvement in the Solomon Islands' economic performance registered after the arrival of the Australian-led intervention force in mid-2003 has continued.

- **The economy has begun to recover.** Strong commodity exports and substantial donor support drove growth and strengthened the external position significantly in 2004. Inflation moderated from its conflict peak. Likewise, the budget recorded a large surplus. Although moderating, growth is supported by two major projects restarting in 2005. The projected deterioration in the external current account reflects investment-related imports, but reserve coverage should remain comfortable. The budget is projected to record a small deficit due to one-off factors and higher spending as capacity and wages rise.

- **Despite a positive near-term outlook, the country faces enormous challenges.** With logging set to decline from its unsustainable level, much depends on new private activities coming on stream to replace lost incomes, exports, and government revenue. The Solomon Islands is the poorest country in the Pacific, with per capita GDP two thirds of its preconflict level. The key challenge is to sustain per capita income growth and broaden its base, while safeguarding macroeconomic stability.

Key Policy Issues

The discussions focused on the macroeconomic policies needed to support the reform process over the medium term. Now is a good opportunity to tackle long-standing issues, provided the forthcoming elections do not derail reforms.

- **A strong fiscal position should be maintained over the medium term.** With expenditure pressures set to rise and revenues projected to fall, staff suggested a 1½ percentage points of GDP adjustment in the 2006 budget. This year's deficit should also be kept below budget.

- **The central bank's policy to resist upward pressure on the exchange rate is appropriate.** The CBSI has de facto pegged the currency to the U.S. dollar since 2003. Downward pressure on the exchange rate should not be resisted. With the conduct of monetary policy likely to become more challenging, the CBSI should continue to stand ready to take appropriate measures, were credit growth to become inflationary.

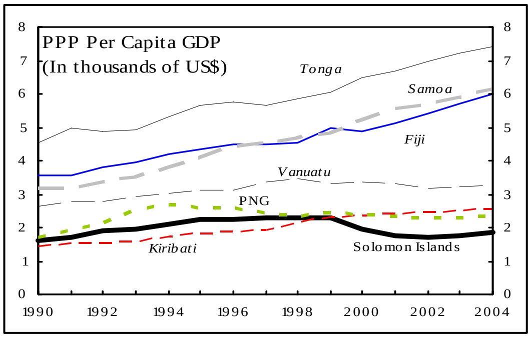
- **After regularizing its domestic debt, the government is seeking debt relief from its external creditors.** The staff's debt sustainability analysis suggests that debt is high and its dynamics fragile.

- **Structural reforms should be accelerated to promote private sector development.** The new foreign investment regime should be introduced, state enterprise reform deepened, and governance reform vigorously pursued.

I. BACKGROUND

1. **The recovery that began in mid-2003 has continued, but structural reforms have lagged.** With the restoration of law and order and extensive donor assistance after the Australian-led intervention-force (Regional Assistance Mission to the Solomon Islands, RAMSI) arrived in mid-2003, macroeconomic stability has been maintained and some improvements in service delivery achieved. The government has begun addressing some of the reform priorities identified in the 2003–06 *National Economic Recovery, Reform, and Development Plan* (NERRDP)—law and order, good governance, financial stability and public sector reform, revitalizing the productive sector, rebuilding infrastructure, restoring basic services, and fostering social development—but progress has been mixed.

2. **Enormous challenges remain.** Per capita GDP is still only two thirds of the preconflict level as the civil conflict of 1999–2000 destroyed infrastructure and disrupted economic activity. Given rapid population growth, it would take about 27 years of 4½ percent annual growth to reach preconflict per capita GDP. The Solomon Islands has the lowest real per capita GDP of all Pacific island countries (PICs), and the gap with the best performing PICs has almost doubled in the past 20 years. Although data deficiencies hamper the assessment, several social indicators appear to fall well short of the Millennium Development Goals (MDGs), with high incidence of malaria and almost a third of the population lacking access to safe water (Annex VI).



3. **While the conflict set the Solomon Islands back, its economic problems have deeper roots.** In particular, obstacles to private sector development—such as limited infrastructure, ill-defined property rights, and labyrinthine regulations—have made the economy overly-reliant on timber. Weak governance and public sector management have also fostered macroeconomic imbalances.

4. **The country is at a cross-roads—logging will decline, and unless growth picks up elsewhere, living standards will fall.** At the current, unsustainable rate, the authorities estimate that logging will exhaust forests by 2015, making it critical to develop a sustainable forestry management plan, and create an environment conducive to growth in other sectors—mainly agricultural commodities, mining, tourism, and small manufacturing.

5. **Previous Article IV consultations have underscored the need to maintain macroeconomic stability while tackling structural reforms.**[1] Although macroeconomic

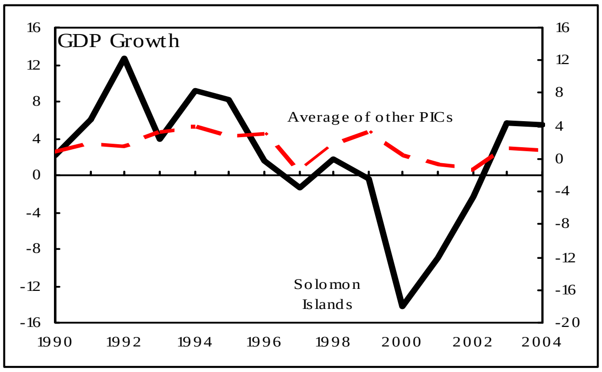
[1] Directors' comments at the conclusion of the 2004 Article IV consultation can be found at http://www.imf.org/external/np/sec/pn/2004/pn0489.htm.

stability has been maintained, progress on structural reforms has been slow. In the fiscal area, tax administration has improved, and the government has started work on a medium-term fiscal framework. Nevertheless, recommendations to avoid new income tax exemptions and generalized wage increases unless in the context of realized savings in the rest of the wage bill have not been followed. In the structural area, work has started on a wide range of reforms, but progress, especially on the legislative front, has been slow, as attaining reform buy-in has required extensive consultations.

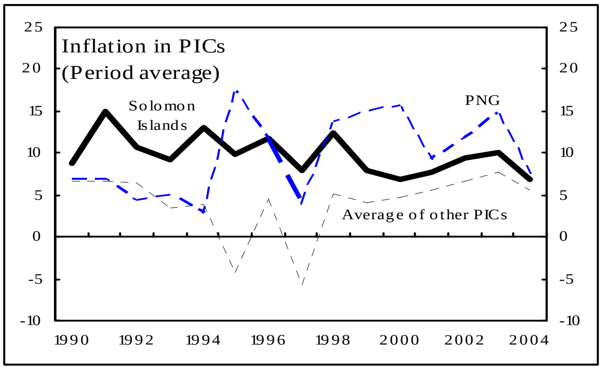
6. **The political situation is fluid.** The parliamentary elections, scheduled for early 2006, might make it difficult to accelerate the reform agenda. Further, with volatile political allegiances and typically a high turnover of parliamentarians in any election, the result is unpredictable.

II. Recent Economic Developments and Near-Term Outlook

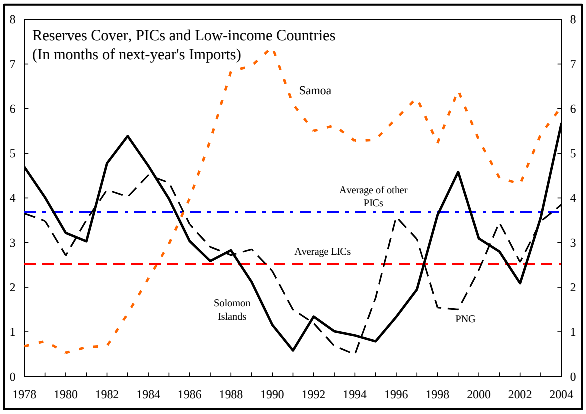
7. **The recovery should continue this year, keeping the Solomon Islands' real growth rate above the regional average.** Boosted by logging, real GDP growth was 5½ percent in 2004 for the second year running (Table 1 and Figure 1). Two major projects, the reopening of a palm oil plantation and the rehabilitation of a gold mine, started earlier this year. Real growth is projected to moderate somewhat to 4½ percent in 2005 because of no net contribution from logging (despite it remaining at about four times the sustainable rate), but new activities should raise nonlogging growth to 5 percent from 3¼ percent in 2004. The Solomon Islands' growth in the past three years has been about 2½ percentage points above the PICs' average, after several years of underperformance.



8. **After rising to 7.8 percent by end-2004, inflation is projected to be broadly unchanged in 2005, remaining above the regional average.** Inflation rose in 2004 due to increased nontradable demand by expatriates and rising fuel prices. This year, inflation is projected to remain at about the 2004 level, due to the continued pass-through of persistently high oil prices and the pickup in economic activity.



9. **Following a large improvement in 2004, the external position is projected to be less favorable in 2005.** Export volume growth exceeded 35 percent in 2004, with both timber and other primary commodity exports booming. This, coupled with low imports and an almost doubling of current transfers, resulted in a 12½ percent of GDP current account surplus. Net international reserves (NIR) rose to US$76 million (5½ months of imports)—high by historical and comparators' standards—boosted also by sizable inflows of official development assistance (Table 2 and Figure 2). The deterioration expected in 2005, with the current account shifting to a deficit of 11 percent of GDP, is mainly due to the high import content of investment projects, a rising oil import bill, and recovery from a low import base. With development grants and FDI (linked almost entirely to the two major projects underway) expected to be strong, NIR should decline only marginally to about US$75 million, 4.5 months of projected 2006 imports.



10. **After an unusually large surplus in 2004, the fiscal position is projected to post a small deficit.**[2] The central government surplus was 8¼ percent of GDP in 2004 due to higher grants, improved tax collection, eliminating militia payments, tighter expenditure controls, and limited spending capacity (Table 3 and Figure 3). Strong growth and clearing of most domestic arrears cut the public debt-to-GDP ratio to 92 percent from 122 percent in 2003. Despite further tax revenue gains, a small deficit (½ percent of GDP) is projected in 2005, as spending capacity and the wage bill rise, and external direct budget support falls. The public debt-to-GDP ratio should fall again modestly, but the realization of contingent liabilities equivalent to 6½ percent of GDP is projected to lead to a slightly higher NPV of external debt to GDP and to exports, both above thresholds.

11. **Reserve money growth was primarily reflected in a large buildup of banks' excess reserves in 2004, but credit growth has recently picked up.** Soaring net foreign assets at the central bank led to a 74 percent rise in reserve money in 2004, despite a buildup of government deposits (Table 4 and Figure 4). Banks' caution limited real private credit growth to 2.5 percent and resulted in banks accumulating excess reserves amounting to 39 percent of deposits. Reflecting the pickup in economic activity, real private credit growth rose to 21 percent year-on-year in May and banks' excess reserves dropped to 32 percent of deposits.

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[2] Due to data availability, the analysis of the fiscal position is limited to the central government.

III. POLICY DISCUSSIONS

12. **With broad agreement on the challenges facing the Solomon Islands, discussions focused on the macroeconomic policies needed to support the reform process over the medium term.** The critical challenges are to sustain growth, broaden its base, and address poverty, while safeguarding fiscal sustainability and sound monetary and financial sector policies. It was recognized that structural reforms play a key role in achieving these goals. While highlighting the risks of inaction, staff stressed that the current situation offers an opportunity to tackle long-standing issues, provided budget discipline is maintained and large donor assistance continues as expected.

A. Medium-Term Outlook

13. **Two key uncertainties shroud the medium-term outlook:**

- **The contribution of logging and activities that could replace it.** The contribution of logging to growth over the next few years depends on whether sustainable forestry management will be introduced and, if so, when. The contribution of other sectors to growth, mainly agricultural commodities and mining, will depend on investor confidence and an improved business environment, as well as technical factors affecting individual sectors, such as mining exploration.

- **The amount and timing of donor flows.** The largest single donor, Australia, recently committed funding for AusAID and RAMSI through 2009, with indications that assistance will continue beyond that date. The European Union has pledged a substantial amount, although disbursements have been slow. New Zealand's budget support is scheduled to end in 2006, but continued assistance has been signaled. While these flows are expected to continue to be sizable over the next several years, they will likely moderate and, their pace and size remain unpredictable.

14. **The staff's baseline medium-term macroeconomic scenario illustrates the potential rewards of the authorities' planned reforms.** Under the assumptions that macroeconomic stability is maintained, a critical mass of structural reforms is implemented (see below), and RAMSI and donors stay engaged, staff projects that annual growth could plausibly average about 4½ (1½ per capita) percent in 2006–10, driven mainly by private investment and exports (Annex I, and Tables 5 and 6). Inflation is projected to decline gradually. The external current account deficit would peak in 2006, due to imported capital goods, and narrow gradually over the projection horizon as export capacity is developed. Reserves would fall modestly as aid moderates, but reserve coverage would stabilize at four months of imports. Nevertheless, all projections are subject to considerable uncertainty.

15. **Risks to the baseline scenario are skewed to the downside, even though a faultless implementation of reforms might engender a stronger supply response.**

Downside risks stem from lackluster policy implementation, political instability, lower donor flows and international commodity prices, and disruptions in the development of major projects. Staff views setbacks in policy implementation as the main risk at least in the near term, partly because of the upcoming elections. Further, this phase of economic reform is more difficult than the initial stabilization, as it requires confronting vested interests and improving governance. A slow reform process, simulated in the staff's alternative scenario, would undermine macroeconomic stability and could limit donor support (Table 7). Lack of economic opportunities could also rekindle ethnic tensions. Given high external vulnerability, the external position would deteriorate if new export activities do not commence, also because private remittances are not sizable (Table 8). In such a scenario, debt service arrears would likely accumulate and imports contract. The fiscal accounts would also come under strain and force a large reduction in public services and spending. On the other hand, a stronger reform drive with flawless implementation could push growth to an annual average of about 6 percent in 2006–10.

16. **The authorities broadly agreed with the staff's analysis, and underscored the complexity of their task.** They welcomed the focus on the medium term and expressed their intention to advance reforms to stimulate growth, while pointing out that slow implementation of some infrastructure projects also reflected donors' slow disbursements. The authorities shared the view that growth needs to be private-sector led, with the public sector establishing the enabling environment. Further, they explained that the government's current poverty reduction strategy centers around promoting growth, and noted that the subsistence economy plays an important role in alleviating extreme poverty and providing a buffer against shocks. Nevertheless, highlighting the difficulties, the authorities described their starting point as comprising a degraded public sector, weak institutions, and obsolete or non-existing infrastructure.

B. Fiscal Policy

17. **The 2005 budget envisages a shift to a 1½ percent of GDP deficit from an 8¼ percent of GDP surplus in 2004.** About half of the deterioration in the budget balance is due to exceptional, one-off factors, primarily Australia ending direct budget support (3.3 percent of GDP) and revenue from a tax amnesty and payment of back taxes (1 percent of GDP) in 2004, and a civil servants bonus paid in June 2005 (0.8 percent of GDP). Also, the budget allocates additional resources for key priorities and higher spending is partly due to the government's taking over some programs previously run by donors. While acknowledging the importance of the special factors affecting the budget in 2004–05, staff cautioned against an overly expansionary fiscal stance and its implications for the budget over the medium term, arguing that the budgeted expenditure increase could be too large to be spent well at current capacity levels and that a stronger budget balance would avoid frequent changes of direction in fiscal policy.

18. **Staff advised saving any revenue over-performance and any under-spending on investment projects and in other areas that may occur this year, while holding current expenditure tightly to the budget.** Tax revenue is likely to over-perform as tax

administration improvements yield results, and logging and import duties are on track to exceed budget estimates. The pace of domestically-financed capital spending, some government programs, and the process of filling vacancies are again likely to fall prey to capacity constraints. Some current spending overruns, especially in administrative and representation costs, are expected, but should not fully offset other factors. Provided the government resists emerging spending pressures in nonpriority areas, the budget outturn could be roughly 1 percent of GDP better than budgeted.[3] The authorities noted that expenditure pressures were intensifying, but were fairly confident to keep within budget even if the contingency warrants are spent. Under existing legislation, the cabinet has the power to spend a certain amount beyond parliamentary appropriations, the so-called contingency warrants, which in 2005 amount to 1 percent of GDP for recurrent outlays and an equal amount for development spending. In the staff's projection, only the recurrent contingency warrant is assumed to be utilized.

19. **Medium-term fiscal risks loom.**[4] Besides spending pressures arising from wage demands and administrative costs, social, infrastructure, and operations and maintenance needs are likely to strain the budget going forward. An anticipated decline in aid flows over time is one source of these pressures, as services currently offered by donors, as well as infrastructure construction projects will be taken on by the government. Maintenance costs for new infrastructure will also become an increasingly important source of these pressures. On the revenue side, direct foreign budgetary support is likely to decline further, and tax receipts from logging and imports (due to tariff reductions as part of the Pacific Island Countries Trade Agreement) are expected to fall. Moreover, the government still has a substantial stock of arrears, and debt servicing costs are projected to rise.

20. **To meet the medium-term challenge that the Solomon Islands faces, the authorities agreed that the 2006 budget should seek to consolidate the fiscal position.** Given limited sources of financing and the need to reduce public debt to safer levels, an adjustment of about 1½ percentage points of GDP would be appropriate and is feasible. It could be obtained by ensuring this year's 16 percent bonus to civil servants is not incorporated in base salaries (equivalent to about ¾ percent of GDP), further tax administration gains, containing nonproductive outlays, and, if necessary, by adjusting excises, fees, and the determined prices for logs (which has not been done in years).

21. **The authorities said that decisions regarding the composition of public expenditure require careful medium-term planning.** Currently, donors are providing several basic government services. Spending for police and law and justice is high in the

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[3] In contrast to budget support grants, development grants, for which very limited data exist and are estimated by staff, are currently administered directly by donors, and hence cannot directly generate a surplus for the government budget.

[4] These risks are discussed in the Selected Issues paper.

present post-conflict situation and should decline over time. Also, these services will cost less once provided by local personnel. Nevertheless, as donors scale down their activities, the government will need to decide which services to provide, as well as the level of infrastructure spending.

22. **The authorities have started work toward a medium-term fiscal framework and welcomed the staff's proposal of a combined-source budget.** A medium-term fiscal framework would help determine the resource envelope and avoid large swings in the level of public services. Incorporating donor flows into a combined-source budget would be an important tool to help the government decide on the level of services, by providing a quantification of the overall level of services currently offered, at present unavailable due to scant information on donor activities. It should also improve the fit between the government's priorities and donors' projects and facilitate donor coordination.

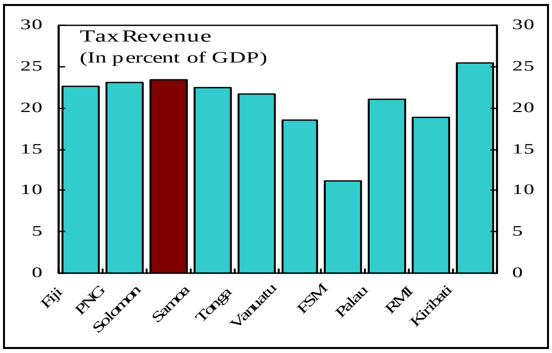
23. **The government needs to make spending more productive.** The Solomon Islands' 2005 wage bill is the highest among the large PICs, and PICs generally have wage bills well above the low-income country average. Staff encouraged the authorities to accelerate preparations for a comprehensive civil service reform, which should be integrated within the medium-term budget framework. To deal with the tension between containing the wage bill and filling critical vacancies, room for needed qualified professionals could be created by rationalizing civil service employment and decompressing the wage scale. In the social sectors, obtaining better outcomes for already sizable levels of spending and reallocating resources toward primary education and health care has priority.

Social Spending and Wage Bill in Selected Pacific Island Countries
(In percent of GDP)

	Education Spending	Health Spending	Wage Bill
Solomon Islands 1/	**8.5**	**4.0**	**10.6**
Fiji	5.6	2.7	10.4
PNG	2.3	3.9	9.2
Samoa	4.8	4.7	7.9
Other PICs average	6.4	5.2	17.7
East Asia and Pacific	3.2	1.9	...
Low-income countries	3.2	1.5	5.7

Sources: World Bank, 2005 World Development Indicators, IMF Staff Reports
1/ Budget figures for 2005

24. **Over the medium-term, widening the tax base is imperative.** While the tax revenue-to-GDP ratio is broadly in line with other PICs, tax rates, with the exception of excises, are among the highest in the region. Staff urged the authorities not to grant new tax exemptions, reduce the scope of existing ones, and continue implementing the Pacific Financial Technical Assistance Center's (PFTAC) recommended tax and customs administrative reforms. The authorities responded that no future tax holidays are envisaged, but noted that the backlog of logging duty exemptions would continue to erode revenue for some time.



Tax Rates in Selected Pacific Island Countries

	Personal Income Tax 1/	Corporate Income Tax	Sales Tax or VAT
Solomon Island	40	30 2/	15 3/
Fiji	32	30	12.5
Kiribati	35	25	0
PNG	47	30	10
Samoa	29	29	12.5
Vanuatu	...	...	12.5
Tonga	10	30	15

Sources: Fund staff reports.
1/ Highest income bracket.
2/ Corporate tax rate for non-residents is 35 percent.
3/ Sales tax rate for rice is 5 percent and other consumption goods is 10 percent.

25. **The tax reform being considered by the authorities envisages a VAT-type tax as the linchpin of the indirect taxation system.** The authorities noted that the proposed tax reform would have several advantages, notably eliminating distortionary effects, especially cascading under the present goods and sales taxes, removing most of the existing exemptions, and providing an alternative revenue source to replace the loss from import and logging duties anticipated over the medium term. Later, the tax reform would also simplify direct income taxes and lower rates.

26. **Staff advised caution on fiscal decentralization.** As plans to implement a federal system are being actively discussed, they continued to advise that fiscal decentralization was not prudent until public finances and administrative capacity strengthen and would likely entail weaker fiscal discipline. The authorities noted that the aim of decentralization would be to improve service delivery in the provinces and that any move toward decentralization would take a long time to implement. If this proposal were to go ahead, safeguards to prevent local governments from borrowing should be put in place.

C. Debt

27. **The authorities described their debt situation as "unsustainable," and were keen to regularize it.** They pointed to the narrow revenue base, the large arrears, and the high opportunity cost of servicing debt given the country's development spending needs. Hence, they viewed the need to regularize the external debt situation as a critical ingredient to support reforms. The government is proceeding with its Honiara Club proposal to restructure external debt and clear external arrears. The authorities explained that they were seeking debt relief from their external creditors and viewed the multilateral framework to be provided by the Honiara Club under the auspices of a broker as more propitious than bilateral negotiations. They expected that these negotiations would start after the conclusion of this consultation. On the domestic side, having restructured domestic bonds in 2004, the government is gradually paying expenditure arrears owed mainly to suppliers

Solomon Islands: External Debt as at end-2004
(In millions of US$)

	Outstanding Balance	Share of Total
Total (including arrears)	159.9	100.0
Arrears 1/	15.8	9.9
Total (excluding arrears)	144.1	90.1
Multilateral	100.1	62.6
Of which:		
Asian Development Bank	49.5	30.9
World Bank (IDA)	46.4	29.0
Bilateral	37.0	23.1
Commercial	7.1	4.4

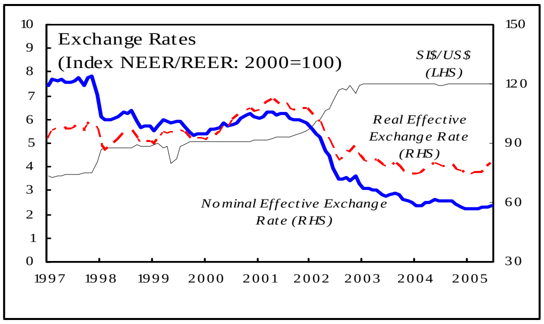
Sources: Solomon Islands' Authorities and Fund staff estimates.
1/ Arrears are principally to bilateral and commercial creditors.

(amounting to about 8 percent of GDP) and formulating plans on how to handle the largest claims.

28. **Staff encouraged the government to normalize relations with its creditors and discussed the debt sustainability analysis (DSA).** Staff also underscored the importance of honoring future debt service obligations. The staff's DSA suggests that debt is high, with some indicators currently above thresholds, and its dynamics fragile (see Annex I). Although debt indicators improve over time in the baseline scenario, some scenarios and shocks, even some temporary ones, could cause debt ratios to deteriorate significantly. These findings, combined with the country's poor credit history, and the high likelihood of further contingent liabilities being realized, suggest that the Solomon Islands is at high risk of debt distress.

D. Exchange Rate and Monetary Management

29. **Staff continued to support the CBSI's policy to resist upward pressure on the exchange rate in the face of strong foreign inflows.** After depreciating by 34 percent in 2002, primarily reflecting the civil unrest, the CBSI has de facto pegged the Solomon Islands dollar to the U.S. dollar since early 2003, and has indicated that this exchange rate regime would be maintained in the near term. Staff supported this policy as reserve accumulation in these circumstances is appropriate because large aid flows are expected to be volatile, and taking this opportunity to build reserves helps buffer the economy against the influence of these flows and potential external shocks. An appreciation of the exchange rate would reduce external competitiveness, and although export performance is heavily influenced by supply factors, it would undesirably disadvantage exporters additionally through prices.



30. **As aid flows diminish and imports grow in line with the economy, staff suggested that downward pressure on the exchange rate should not be resisted.** Given the country's exposure to external shocks and the priority of maintaining an adequate level of reserves, the CBSI agreed with this advice, and indicated that the exchange rate regime would be reviewed when necessary. They explained that, at a minimum, reserves should cover 3½ months of imports and agreed that the real exchange rate level—almost 20 percent lower than pre-conflict levels—appears broadly adequate at present, as indicated by the positive performance of nontimber exports.

31. **The exchange rate has so far provided an effective nominal anchor, but going forward the conduct of monetary policy is likely to become more challenging.** Inflation has remained below 8 percent in the past two years, but continued strong foreign inflows and a substantial drawdown of government deposits or banks' excess reserves as credit rises could jeopardize the CBSI's single digit indicative target, given the limited instruments at its disposal. The Governor explained that, if credit growth were to become inflationary, the

CBSI stands ready to take appropriate measures, including moral suasion and administrative measures, if necessary. Improving the functioning of the T-bill market could also be pursued to develop indirect instruments for liquidity management in the future, but its contribution in the short run would be limited due to the perceived risk of government debt.[5]

E. Financial Sector Issues

32. **The commercial banking system continues to perform well, while the development bank should be liquidated.** All commercial banks—comprising two foreign banks with a combined market share of 57 percent and a local private bank—are well capitalized and the aggregate capital to risk-weighted assets ratio is over 25 percent. Asset quality has improved with a decline in nonperforming loans to 1.9 percent of total from 5.5 percent at end–2003. Despite the recent fall, profitability remains robust (return on equity averages about 20 percent) and liquidity is high.[6] The CBSI, as the court-appointed manager, has made progress in repaying depositors of the troubled Development Bank of the Solomon Islands (DBSI) and shrinking its balance sheet. Staff advised to liquidate the DBSI and confront the challenge of financing the institution's liquidation, currently estimated to cost ¾ percent of GDP.

33. **The profitability of the National Provident Fund (NPF) remains a concern.** Despite improved liquidity, poor asset quality (nonperforming assets are estimated at 13 percent of total) and low yields affect the NPF's ability to generate a return sufficient to cover operating costs and the 2.5 percent annual return to contributors mandated by law. The authorities noted that greater transparency in the NPF's operations had already been introduced and efforts were being made to improve governance and redefine the objectives of the institution to protect members' contributions, including by preparing a new NPF bill. Staff recognized the benefits of allowing the NPF to invest abroad, especially given limited domestic investment opportunities, but advised that conservative investment guidelines be adopted to prevent asset mismanagement.

34. **Staff welcomed the progress on anti-money laundering and combating the financing of terrorism (AML/CFT).** After the amended AML Act came into force in May, the CBSI issued the Customer Due Diligence guidelines to banks to introduce reporting requirements for AML/CFT. With the Fund's and donors' assistance, a financial intelligence unit is in the process of being established.

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[5] The development of the T-bill market is discussed in the Selected Issues paper.

[6] While deposit-lending spreads remain high due to the high risk environment, banks typically offer lower lending rates to clients with good creditworthiness and hence high spreads are not deemed an obstacle to private sector development. Although spreads obviously contribute, the major source of banks' profitability are foreign exchange transactions.

F. Structural Reforms and Other Issues

35. **The newly established Economic Reform Unit is leading several reform efforts to meet the NERRDP objectives, but much remains to be done to implement them.** The authorities and staff shared the view that reforms to promote a better business environment, reforming state-owned enterprises (SOEs), enhancing infrastructure, and improving governance are key priorities, with building civil service capacity a prerequisite for all of them. Staff highlighted the signaling effect of individual reforms reaching the implementation stage and the importance of sustaining the reform momentum to support business confidence.

36. **A new foreign investment bill is spearheading the efforts to improve the business environment.** The proposed bill would reform the investment regime—rendering the registration process simpler, more transparent, and nondiscretionary—but awaits parliamentary passage. Staff also encouraged the authorities to proceed with a review of investment incentives and administrative barriers to businesses (especially, business licensing procedures and foreign labor permits), which the Foreign Investment Advisory Service of the International Finance Corporation is facilitating.

37. **SOE restructuring has advanced somewhat.** Staff commended the authorities' efforts to restructure Solomon Airlines, expected to be ready for privatization in late 2005, and suggested that it might serve as a model for reforming other SOEs. With the assistance of the World Bank, a draft restructuring plan for the Solomon Islands Electricity Authority has been prepared, although some key decisions have yet to be made. It is expected that the restructuring of the Water Authority would start next. A review of the regulatory environment for utilities is also being considered and the audited accounts of public enterprises are being prepared. SOE restructuring would improve service delivery and support the revival of economic activity, as well as reduce fiscal risks, as some of these companies are making losses mainly financed via inter-institution arrears.

38. **With external assistance, infrastructure is slowly starting to be rebuilt.** Financed by donors, road construction and other infrastructure projects have recently commenced. The Asian Development Bank (AsDB) is assisting the government in strengthening the ministry of infrastructure and develop a national transport plan. Inter-island shipping, a key ingredient to rural development, is also being addressed and additional wharves are being built.

39. **The authorities recognize the importance of better governance and, with RAMSI's assistance, are making progress in several areas.** Last July, parliament approved legislation to introduce a single ballot box, which is expected to reduce the scope for vote-buying. Programs to strengthen many institutions, including parliament, the justice system and watchdogs, and increase the participation of civil society in oversight are under way. Some economic institutions, for example the Ministry of Finance and the NPF, have become more transparent by publishing regular press briefings and their accounts.

40. **The authorities are improving the statistical database, which is barely adequate for surveillance and continues to hamper it (Annex VII).** Data deficiencies are significant in the real, fiscal, and external sectors. With the exception of crude GDP estimates, national accounts have not been produced since 1994. Very limited data are available on donor activities and the accounts of public institutions outside the central government do not exist. Partial balance of payments data are estimated using foreign exchange transactions, and are suspected to misstate trade. These shortcomings make assessing the fiscal stance and the external position challenging. The National Statistical Office (NSO) is beginning a household income and expenditure survey this October, plans to prepare complete national accounts in 2006, and is preparing preliminary trade estimates based on customs data. Staff and the authorities agreed on the need to collect data on aid flows and produce accounts for public institutions outside the central government.

IV. Staff Appraisal

41. **The notable improvement in the Solomon Islands' economic performance, which started after RAMSI's arrival, has continued.** Against the backdrop of improved security, macroeconomic stability has been maintained and economic activity has rebounded. The authorities have achieved better service delivery and started to work on structural reform. Aid flows have risen, and donors have pledged assistance for some time to come.

42. **Nevertheless, major challenges remain.** The key issue is to sustain per capita growth over the medium term, while logging will decline from its present unsustainable rate. This requires embracing structural reform and setting macroeconomic policies within a longer-term horizon. Structural reforms are needed to promote private sector development. Fiscal reforms have to ensure adequate provision of government services and infrastructure without jeopardizing fiscal sustainability. Price stability is necessary for a stable macroeconomic environment. Now is a good opportunity to tackle long-standing issues, but risks are skewed to the downside.

43. **Given limited financing sources and the need to reduce public debt, the government must consolidate its budget.** A start toward this could be made by ensuring that this year's budget outturn comes in better than budgeted. This could be achieved by saving any revenue overperformance and any underspending, while holding current outlays tightly to the budget. There is also an opportunity in the 2006 budget to consolidate the fiscal position by ensuring one-off bonuses paid to civil servants in 2005 do not enter base salaries, pursuing further tax administration gains, and containing nonproductive expenditure. Although debt indicators improve under the baseline scenario, fragile debt dynamics and the country's credit history suggest that the Solomon Islands is at high risk of debt distress. The authorities should normalize relations with creditors as soon as possible.

44. **Over the medium term, the efficiency of government spending will have to be substantially raised and revenue should be kept broadly constant in relation to GDP.** Spending decisions and a civil service reform should be set within a medium-term budget framework and a combined-source budget incorporating aid flows. The government should

start re-orienting expenditure away from the wage bill and toward infrastructure, maintenance, and primary education and health care. No new tax exemptions should be granted and the scope of existing ones curtailed. The proposed tax reform would go a long way in improving revenue generation. Fiscal decentralization, at least until public finances and capacity strengthen, would be imprudent and would likely weaken fiscal discipline.

45. **The policy of stabilizing the exchange rate in the face of strong foreign inflows is appropriate.** The CBSI has de-facto pegged the Solomon Islands dollar since early 2003 and rebuilt reserves, as large aid flows are expected to be temporary and volatile. However, downward pressure on the exchange rate should not be resisted given the country's exposure to external shocks and the priority assigned to maintaining an adequate reserve level. External competitiveness appears adequate at present.

46. **The exchange rate regime has so far served the country well as a nominal anchor, but going forward, the conduct of monetary policy could become more challenging.** As the CBSI has recognized, continued strong foreign inflows combined with a drawdown of government deposits and an acceleration in private credit growth might jeopardize its indicative single digit inflation target. The CBSI should continue to stand ready to rein in credit growth, including, if necessary, via administrative measures, given limited instruments at its disposal.

47. **The commercial banking system continues to perform satisfactorily, though the NPF's weak profitability is a concern and the DBSI should be liquidated.** Commercial banks are well capitalized and asset quality has improved. The NPF, however, continues to suffer from low profitability, despite improved liquidity. Letting the institution invest abroad could be beneficial, but strict investment guidelines should be adopted first. The new NPF bill should be passed. Pressures to revive the DBSI should be resisted and the bank liquidated.

48. **Structural reforms play a crucial role in creating an enabling business environment for private sector development and achieving higher per capita income.** Passage of the foreign investment bill would send a signal to investors and donors about the authorities' commitment to reform. Deepening and extending SOE reform, in particular of the utilities, is needed to improve service delivery and reduce fiscal risks. Infrastructure is slowly being rebuilt, which is key to boost new economic activities. Better governance and institution strengthening are afoot in a number of areas and their continuation is critical in maintaining confidence and ensuring equal opportunities for all in society.

49. **The statistical database is barely adequate for surveillance and continues to hamper it.** Data shortcomings in the real, fiscal, and external sectors, hinder the assessment of the fiscal stance and external position. Nonetheless, remedial efforts are under way in a number of areas.

50. **It is proposed that the next Article IV consultation be conducted on the 12-month cycle.**

Table 1. Solomon Islands: Selected Economic Indicators, 2000–05

Nominal GDP (2004): US$258 million
Population (2004): 469,400
GDP per capita (2004): US$550
Quota: SDR 10.4 million

	2000	2001	2002	2003	2004 Est.	2005 Proj.
Growth and prices (percentage change)						
Real GDP	-14.3	-9.0	-2.4	5.6	5.5	4.4
Of which : Marketed output	-19.9	-13.9	-4.8	8.9	7.8	5.0
CPI (period average)	6.9	7.6	9.4	10.1	6.9	6.6
CPI (end of period)	7.6	6.5	15.4	3.8	7.8	8.0
Nominal GDP (millions of SI$)	1,523	1,447	1,527	1,710	1,932	2,151
Nominal GDP (millions of US$)	299	274	226	228	258	285
Per capita GDP (in US$)	714	637	510	499	550	591
Central government operations (percent of GDP)						
Total revenue	22.1	23.5	18.8	37.6	48.9	48.5
Recurrent revenue	18.3	15.3	16.2	19.5	26.8	26.6
Grants	3.7	8.2	2.6	18.1	22.1	21.8
Total expenditure 1/	29.9	36.2	29.8	39.5	40.6	49.0
Recurrent expenditure	25.3	27.3	26.6	23.9	22.9	27.9
Development expenditure	4.6	8.9	3.2	15.6	17.7	21.1
Recurrent balance 2/	-6.3	-11.8	-10.0	-0.5	8.4	1.0
Overall balance 3/	-7.8	-12.7	-11.0	-1.9	8.3	-0.5
Foreign financing (net)	0.6	5.0	3.8	0.4	-1.6	-0.6
Domestic financing (net)	4.2	-1.4	-3.0	-9.0	-6.7	1.3
Other	0.4	8.5	9.0	10.0	-2.4	-0.2
Stock of expenditure arrears (in percent of GDP, end of period) 4/	4.9	8.9	12.1	14.9	8.0	7.8
Domestic principal arrears (percent of GDP)	0.0	3.9	7.1	12.1	0.0	0.0
Central government debt (percent of GDP) 5/	69.7	94.1	114.1	122.0	92.3	88.0
Domestic	27.8	45.1	47.1	51.5	30.4	26.7
External	42.0	49.0	67.0	70.6	62.0	61.4
External debt (in US$ millions, end of period)	125.6	134.3	151.6	160.8	159.9	175.1
External debt service to exports of GNFS (accrual basis)	3.9	8.1	10.3	9.0	5.9	7.8
Monetary and credit (percentage change, end-year data)						
Net foreign assets	-39.8	-31.8	30.2	106.4	111.0	0.8
Net domestic assets	46.8	-4.4	-4.8	-11.0	-60.4	85.1
Net domestic credit	23.0	-7.2	11.0	-0.7	-36.1	43.3
Credit to private sector	1.8	-21.8	12.2	26.1	10.6	40.0
Broad money	0.5	-13.2	4.0	26.0	28.1	13.4
Interest rate (3-month t/bill rate, average) 6/	7.3	8.9	8.3	5.8	6.0	3.5
Balance of payments (US$ millions, unless otherwise indicated)						
Exports, f.o.b	65.1	47.1	57.8	74.2	96.7	100.2
Imports, c.i.f.	-98.1	-90.6	-62.3	-85.2	-98.7	-140.3
Current account	-31.7	-35.1	-16.3	3.1	32.3	-30.8
(Percent of GDP)	-10.6	-12.8	-7.2	1.3	12.5	-10.8
Capital account	8.5	17.2	6.3	11.1	8.1	27.5
Overall balance (accrual)	-23.1	-17.9	-10.0	14.2	40.4	-3.2
Gross official reserves (US$ millions, end of period)	31.3	18.5	17.5	36.0	79.0	78.5
(in months of next year's imports of GNFS)	3.1	2.8	2.1	3.6	5.7	4.7
Exchange rate (SI$/US$, end of period) 6/	5.10	5.56	7.46	7.49	7.51	7.52
Real effective exchange rate (period average, 2000=100) 7/	100.0	109.2	90.8	78.5	77.4	78.3
Nominal effective exchange rate (period average, 2000=100) 7/	100.0	103.2	80.1	64.0	59.6	57.8

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

1/ Expenditures are presented on an accrual basis.
2/ Includes recurrent budget grant support.
3/ Calculated from above-the-line data.
4/ Includes interest arrears.
5/ Includes arrears.
6/ 2005 column reflects data for end-July 2005.
7/ 2005 column reflects data for end-May 2005.

Table 2. Solomon Islands: Balance of Payments, 2000-05

(In millions of U.S. dollars)

	2000	2001	2002	2003	2004 Est.	2005 Proj.
Current account balance	-31.7	-35.1	-16.3	3.1	32.3	-30.8
Current account balance (excl. net public sector transfers)	-32.4	-44.7	-22.9	-6.1	21.3	-35.5
Trade balance	-32.9	-43.5	-4.5	-11.0	-2.0	-40.1
Merchandise exports, f.o.b.	65.1	47.1	57.8	74.2	96.7	100.2
Of which: Timber	44.1	36.1	37.7	49.5	62.6	62.7
Fish	8.1	7.1	10.5	12.4	17.6	16.6
Merchandise imports, c.i.f.	98.1	90.6	62.3	85.2	98.7	140.3
Of which: Petroleum	18.4	14.4	11.2	11.7	23.3	37.6
Services and income (net)	13.8	-6.3	-6.3	0.7	9.0	-2.1
Nonfactor services (net)	14.6	-6.4	-0.4	6.0	7.7	2.4
Net factor income from abroad	-0.8	0.1	-5.9	-5.3	1.4	-4.5
Net current transfers	-12.6	14.7	-5.5	13.4	25.2	11.4
Private sector	-13.3	5.0	-12.1	4.2	14.2	6.7
Receipts	16.5	24.0	15.9	18.4	37.1	14.4
Payments	29.7	19.0	28.1	14.2	22.9	7.6
Public sector	0.7	9.6	6.6	9.2	11.1	4.7
Receipts	2.2	10.0	7.3	14.3	13.0	6.6
Payments	1.5	0.4	0.7	5.2	1.9	1.9
Capital account balance	8.5	17.2	6.3	11.1	8.1	27.5
Government sector	7.3	18.3	5.8	12.2	8.5	20.9
Medium and long-term lending	1.7	13.9	2.7	-0.5	-4.0	-1.7
Inflows	4.4	16.8	6.0	3.1	0.3	3.4
Amortization	2.7	2.9	3.3	3.6	4.3	5.1
Investment flow (projects)	5.5	4.4	3.1	12.7	12.5	22.6
Private sector	1.3	-1.1	0.5	-1.1	-0.4	6.6
Investment activities (including FDI)	2.4	1.0	1.0	-0.1	0.3	7.3
Medium and long-term lending	-0.5	-1.2	0.0	-0.7	-0.5	-0.3
Inflows	0.4	0.0	0.5	0.0	0.0	5.0
Amortization	0.9	1.2	0.5	0.8	0.5	5.3
Other outflows	-0.7	-0.9	-0.5	-0.3	-0.3	-0.4
Overall balance (accrual)	-23.1	-17.9	-10.0	14.2	40.4	-3.2
Commercial bank holdings (increase)	-3.6	3.5	1.4	2.0	2.2	0.0
Errors, omissions, and valuation	-2.2	-4.5	7.2	3.3	1.1	0.0
Exceptional financing	2.7	13.0	3.1	3.0	3.7	2.8
Interest arrears	1.2	2.4	4.1	3.0	2.3	2.0
Amortization arrears	1.5	2.3	3.3	1.5	1.4	1.0
Pending import requests	0.0	8.3	-4.3	-2.4	-1.5	-0.1
Debt forgiveness	0.0	0.0	0.0	1.0	1.5	0.0
Restructured arrears	0	0	0	0.0	0.0	0.0
Overall balance (cash)	-19.1	-12.8	-1.0	18.5	43.0	-0.4
Memorandum items:						
Gross official reserves	31.3	18.5	17.5	36.0	79.0	78.5
(In months of next year's imports of GNFS)	3.1	2.8	2.1	3.6	5.7	4.7
NIR	29.0	16.3	15.8	33.1	76.0	75.5
(in months of next year's imports of GNFS)	2.9	2.5	1.9	3.3	5.5	4.5
(in months of next year's non-project imports)	3.7	3.2	2.5	4.1	6.4	5.3
NIR (excluding pending import requests and external arrears)	24.4	0.9	0.6	17.7	60.0	42.7
(in months of next year's imports of GNFS)	2.4	0.1	0.1	1.7	4.3	2.6
External debt (including arrears)	125.6	134.3	151.6	160.8	160.2	175.4
(in percent of GDP)	42.0	49.0	67.0	70.6	62.1	61.5
External arrears (interest plus principal)	4.6	7.1	11.1	13.8	15.8	32.8
Exports GNFS/GDP	38.0	26.2	32.9	41.9	49.2	45.4
Imports GNFS/GDP	44.1	44.4	35.1	44.1	47.0	58.6
Exports GNFS--Value Growth	-36.1	-36.8	3.7	28.1	33.2	1.9
Exports GNFS--Volume Growth	-33.6	-25.1	-1.7	52.4	35.6	-0.2
Timber Exports--Value Growth	-14.9	-18.2	4.4	31.4	26.4	0.3
Non-Timber Exports--Value Growth	-71.5	-47.5	82.5	22.8	38.3	9.4
Imports GNFS--Value Growth	-17.2	-7.9	-34.7	26.5	20.9	37.8
Imports GNFS--Volume Growth	-19.4	-2.9	-34.7	15.2	8.5	25.6
Current account (including transfers)/GDP	-10.6	-12.8	-7.2	1.3	12.5	-10.8
Current account (excluding transfers)/GDP	-10.8	-16.3	-10.1	-2.7	8.2	-12.4
Exchange rate (SI$/US$, average)	5.09	5.28	6.75	7.51	7.48	...
Terms of trade (index: 1990=100)	117.8	118.1	91.0	80.0	70.7	66.0

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

Table 3. Solomon Islands: Central Government Operations, 2000–05

(In percent of GDP)

	2000	2001	2002	2003	2004 Est.	2005 Budget	2005 Proj.
Total revenue and grants	22.1	23.5	18.8	37.6	48.9	45.1	48.5
Total revenue	18.3	15.3	16.2	19.5	26.8	25.6	26.6
Tax revenue	16.9	14.0	15.5	17.7	24.0	22.3	23.4
Income and profits	6.3	5.1	4.8	3.9	7.7	6.5	7.2
Goods and services	4.4	4.4	4.6	6.5	8.5	8.4	8.5
International trade and transactions	6.1	4.5	6.1	7.3	7.8	7.4	7.8
Tax on logging	...	...	...	3.2	3.3	2.7	3.0
Other revenue	1.5	1.3	0.7	1.8	2.8	3.4	3.2
Stamp duty	0.1	0.1	0.2	0.2	0.2	0.2	0.2
Licenses and fees	0.1	0.1	0.2	0.1	0.3	0.2	0.3
Miscellaneous revenue	1.3	1.0	0.3	1.5	2.3	3.0	2.7
Grants	3.7	8.2	2.6	18.1	22.1	19.5	21.8
Development grants 1/	14.4	8.0	2.2	14.3	17.6	17.6	19.5
Recurrent budget grants	0.7	0.3	0.5	3.8	4.5	1.9	2.3
Expenditure 2/	29.9	36.2	29.8	39.5	40.6	46.5	49.0
Recurrent expenditure	25.3	27.3	26.6	23.9	22.9	27.0	27.9
Compensation of employees	13.1	13.0	11.6	9.4	8.9	10.5	10.1
Goods and services	5.0	5.3	4.7	5.8	7.9	10.9	11.6
Interest	3.6	1.3	3.3	2.8	1.8	1.8	2.3
Grants to provinces	2.7	2.3	0.9	2.0	2.6	2.5	2.6
Employer social benefits	0.3	0.0	0.2	0.2	0.2	0.1	0.1
Other	0.6	5.4	5.8	3.8	1.4	1.0	1.1
Development expenditure	4.6	8.9	3.2	15.6	17.7	19.5	21.1
Grant financed 1/	3.1	8.0	2.2	14.3	17.6	17.6	19.5
Concessional loan financed	1.5	0.9	1.0	1.4	0.1	1.2	1.2
Domestically financed	0.0	0.0	0.0	0.0	0.0	0.7	0.3
Recurrent balance (above the line) 3/	-6.3	-11.8	-10.0	-0.5	8.4	0.4	1.0
Domestic balance (above the line) 4/	-8.4	-12.9	-11.4	-5.7	3.8	-3.3	-2.8
Overall balance (above-the-line)	-7.8	-12.7	-11.0	-1.9	8.3	-1.5	-0.5
Discrepancy (negative are net expenditures)	2.6	0.6	1.2	0.5	2.3	0.0	0.0
Overall balance (below-the-line)	-5.1	-12.1	-9.8	-1.4	10.6	-1.5	-0.5
Financing	5.1	12.1	9.8	1.4	-10.6	1.5	0.5
Foreign (net)	0.6	5.0	3.8	0.4	-1.6	...	-0.6
Disbursements	1.5	6.1	5.4	1.4	0.1	...	1.2
Amortization (accrual)	0.9	1.1	1.6	1.6	1.7	...	1.8
Debt forgiveness	0.0	0.0	0.0	0.7	0.0	...	0.0
Domestic bank and nonbank (net)	4.2	-1.4	-3.0	-9.0	-6.7	...	1.3
Banking system (accrual)	5.2	-3.3	-1.1	-8.8	-8.7	...	1.6
Central bank	4.3	2.9	2.4	-3.9	-5.9	...	2.1
Commercial banks	1.0	-6.2	-3.5	-5.0	-2.8	...	-0.5
Nonbank (accrual)	-1.1	1.9	-1.9	-0.2	2.0	...	-0.3
National Provident Fund	-1.4	0.7	-1.2	0.0	1.7	...	-0.3
Other	0.4	1.2	-0.7	-0.2	0.3	...	0.0
Privatization receipts	0.0	0.0	0.0	0.0	0.0	...	0.4
Increase in expenditure arrears 5/	1.6	3.8	3.7	4.1	-5.2	...	-0.9
Principal debt arrears	-1.2	4.7	5.3	5.8	-10.1	...	0.3
External	-1.2	0.8	1.9	0.1	0.5	...	0.3
Domestic	0.0	3.9	3.4	5.7	-10.7	...	0.0
Restructured Bonds	0.0	0.0	0.0	0.0	13.0	...	0.0
Memorandum items:							
Underlying balance (above the line) 6/	-4.8	-11.6	-8.1	-2.9	4.7	-0.9	0.3

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

1/ Estimated by staff as currently only limited data exist. Development grants and grant-financed development spending are currently administered by donors, and hence are not under the direct control of the government.
2/ On an accrual basis.
3/ Includes domestic revenue, recurrent expenditure, and recurrent budget grant support.
4/ Defined as domestic revenue net of recurrent expenditure and non-grant financed development spending.
5/ Includes interest arrears.
6/ Defined as domestic primary balance excluding one-off items.

Table 4. Solomon Islands: Summary Accounts of the Banking System, 2000–05

	2000	2001	2002	2003	2004 Est.	2005 Proj.
I. Central Bank	(In millions of S.I. dollars, end of period)					
Net foreign reserves	147.7	91.0	117.5	248.3	570.3	574.7
Net domestic assets	6.6	56.8	49.8	-26.6	-186.6	-178.6
Credit to the government (net)	80.0	122.3	159.5	94.6	-20.7	23.7
Claims	54.5	185.2	186.3	186.4	185.4	185.4
Deposits	25.5	-62.9	-26.8	-91.8	-206.1	-161.7
Other items (net)	-73.4	-65.4	-109.6	-121.2	-165.9	-202.3
Reserve money	154.4	149.4	174.0	220.7	383.6	396.1
Currency outside DMBs	88.3	84.7	91.5	102.7	123.2	139.7
II. Monetary survey						
Net foreign assets	148.9	101.6	132.2	273.0	575.9	580.4
Net domestic assets	315.6	301.6	287.1	255.4	101.1	187.1
Domestic credit	457.6	424.7	471.4	467.9	299.2	428.6
Government (net)	258.8	270.0	298.3	250.6	81.7	115.5
Claims	239.0	335.2	336.9	351.3	331.3	320.7
Deposits	19.8	-65.2	-38.6	-100.8	-249.6	-205.2
Credit to rest of NFPS	3.6	1.9	1.8	1.4	-21.3	-21.3
Private sector	195.2	152.7	171.3	216.0	238.9	334.4
Other items (net)	-142.0	-123.0	-184.3	-212.5	-198.1	-241.5
Broad Money (M2)	464.5	403.2	419.3	528.4	677.0	767.4
Narrow money	248.3	246.4	247.1	327.9	427.2	484.2
Quasi money	216.2	156.8	172.2	200.5	249.8	283.2
	(Annual percentage change, end of period)					
Reserve money	1.3	-3.3	16.5	26.9	73.8	3.3
Net foreign assets	-39.8	-31.8	30.2	106.4	111.0	0.8
Net domestic assets	46.8	-4.4	-4.8	-11.0	-60.4	85.1
Net domestic credit	23.0	-7.2	11.0	-0.7	-36.1	43.3
Of *which*: Private sector	1.8	-21.8	-20.7	26.1	10.6	40.0
Broad money (M2)	0.5	-13.2	4.0	26.0	28.1	13.4
Memorandum items:						
Velocity of broad money (marketed output)	2.3	2.5	2.4	2.2	2.0	1.9
Money multiplier	3.0	2.7	2.4	2.4	1.8	1.9
Excess liquidity to deposits ratio	10.1	12.8	17.7	20.2	39.5	33.3
Net international reserves (in millions of US$)	29.0	16.3	15.8	33.1	76.0	75.5
Private sector credit growth in real terms	-5.4	-26.5	-2.8	21.5	2.6	29.6
Government credit (net) growth in real terms	35.0	-2.0	-4.2	-19.1	-69.8	30.9

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