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Solomon Islands: First Review Under the Standby Credit Facility and Request for Modification of Performance Criteria and Re-phasing of Disbursements—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Solomon Islands.

In the context of the first review under the standby credit facility and request for modification of performance criteria and rephasing of disbursements, the following documents have been released and are included in this package:

- The staff report for the First Review Under the Standby Credit Facility and Request for Modification of Performance Criteria and Rephasing of Disbursements, prepared by a staff team of the IMF, following discussions that ended on September 24, 2010, with the officials of Solomon Islands on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 2, 2010. 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 Press Release summarizing the views of the Executive Board as expressed during its November 17, 2010 discussion of the staff report that completed the request and/or review.

- A statement by the Executive Director for the Solomon Islands.

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

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

*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

SOLOMON ISLANDS

First Review Under the Standby Credit Facility and Request for Modification of Performance Criteria and Rephasing of Disbursements

Prepared by the Asia Pacific Department in Consultation with Other Departments

Approved by Subir Lall and Dominique Desruelle

November 2, 2010

Standby Credit Facility. An 18-month Standby Credit Facility arrangement (120 percent of quota or SDR12.48 million) was approved by the Executive Board on June 2, 1010 (Country Report No. 10/198). The first disbursement (SDR 3.12 million) was made in mid-June. Following a national parliamentary election on August 4, a new government took power in late August. It remains committed to program understandings, as affirmed in a Supplemental Memorandum of Financial and Economic Policies.

Summary. The authorities requested the SCF arrangement to help promote fiscal and other reforms, reduce destabilizing imbalances, and close financing gaps, including by catalyzing additional donor support. Program performance is generally good and economic prospects have improved with a pickup in exports and lower inflation. All end-June and other relevant performance criteria and structural benchmarks for the first review were met. However, the end-September benchmark on adjusting the taxable price of logs was not fully met. Looking ahead, formulating a 2011 budget consistent with the program and pushing forward on structural fiscal reforms are critical to ensuring fiscal sustainability. To maintain stability, the central bank will also need to remain vigilant in monitoring liquidity conditions in view of strong external inflows, and stand ready to exit its accommodative monetary stance if inflationary pressures emerge. Reforming the National Provident Fund and strengthening banking supervision are necessary to preserve financial sector stability.

Discussions. A staff team visited Honiara on September 14–24, 2010, comprising Messrs. Cowen (head), Feridhanusetyawan, Peiris, and Zeng (all APD). Mr. Yang (Regional Resident Representative) and Mr. Di Maio (OED) participated in policy discussions. The mission met with the Minister of Finance, Governor of the Central Bank of Solomon Islands, Auditor General, and other senior officials, as well as donor and private sector representatives.

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I. Background

1. **Program performance is broadly on track.** Under the 18-month Standby Credit Facility (SCF) arrangement approved by the IMF's Executive Board in early June 2010, all end-June performance criteria were met. Preliminary outcomes up to September 2010 are broadly in line with achieving program targets. The authorities also implemented the end-June program benchmarks on the annual notification of tax and customs exemptions to Parliament and revisions to lender of last resort provisions of the central bank (Supplemental Memorandum of Economic and Financial Policies (SMEFP), Tables 1–2).

2. **Macroeconomic performance in 2010 has been generally as envisaged at the time of the program request** (Figure 1, Table 1). Real GDP, which contracted 1¼ percent in 2009 (slightly more favorable than originally estimated), is now projected to expand by 4 percent in 2010, given the global rebound in commodity prices, timber production, and new mining and telecommunications investment. Inflationary pressures remain subdued, with the headline rate, at 1 percent (y/y) in August 2010, expected to reach 3 percent by year-end owing mainly to base effects. The current account deficit (including official transfers) is now projected to be somewhat smaller than originally programmed at 25½ percent of GDP in 2010, owing to higher-than-expected log exports (with volumes now expected to increase by 10 percent this year), but still sluggish noncapital imports (Table 2). Combined with private inflows related to mining and telecommunications investment, gross official reserves are expected to reach US$210 million by end-2010 (five months of next year's imports of goods and nonfactor services).

3. **The near-term outlook has improved, despite uncertain global conditions.** Real GDP growth is now projected at 7½ percent in 2011 (compared to 5¼ percent in the original program), owing to a more favorable outlook for gold production—now likely to commence by mid-2011. Inflation is expected to be 4–5 percent in 2011 and over the medium term. The current account deficit should narrow further, factoring in gold exports, with gross reserves projected to increase to US$250 million by end-2011 (six months of imports). The risks to this outlook include a sharper-than-anticipated moderation in global growth, a larger-than-projected decline in logging exports in 2011 and beyond due to rapid depletion of timber stocks, and lagging pickup in domestic demand because of policy uncertainty.

4. **The new government indicated it remains committed to program targets and objectives agreed with the previous government.** The National Coalition for Reform and Advancement (NCRA) government, formed in late August 2010 following a national parliamentary election on August 4, comprises a coalition of six political parties and independent parliamentarians. It convened Parliament in late September, with the first major order of business the passage of a supplementary appropriations bill for 2010 (discussed below). In early October 2010, the NCRA government released its policy statement setting forth its priorities over the next four years. Regarding the economy, the main objective is to shift from heavy reliance on the logging industry to other sectors such as tourism, agriculture, fisheries, and mining. Reform priorities include strengthening macroeconomic management, focused on improved fiscal policies, and engendering private-sector led growth.

II. Policy Discussions

5. **Discussions focused on policy actions needed to ensure program targets and objectives continue to be achieved.** They mainly centered on the appropriateness of fiscal policy in boosting cash reserves, of monetary and exchange rate policies in light of recent strong inflows, and of financial sector reforms in preserving system stability. Program performance criteria on net international reserves (NIR) and net domestic assets (NDA) have been adjusted on account of larger-than-expected inflows this year, with a view to further reducing external vulnerability and maintaining macroeconomic stability. A few structural benchmarks have been updated and several benchmarks have been added to incorporate new commitments by the NCRA government and recommendations from the IMF's Safeguards Assessment.

A. Fiscal Policy

6. **Fiscal performance in 2010 has been broadly in line with program commitments.** Under the program, the government seeks to strengthen public finances by targeting an overall surplus (including grants) of 2½ percent GDP in 2010, in line with increasing the program cash balance by SI$120 million in the current fiscal year.[1] Preliminary indicators through August show fiscal performance as broadly on track. Actions have been taken to ensure a supplementary budget passed by Parliament in late September does not undermine fiscal targets.[2] Overall revenue collection has been better than expected, mainly because of logging export duties and tax administration efforts, compensating for sluggish performance of customs duties and nontax revenue, although the latter should pick up with expected fishing license receipts. Nonwage recurrent spending has been appropriately restrained, in part due to the withdrawal of spending warrants of SI$116 million in May (2 percent of GDP) and temporary reservation of additional warrants, in keeping with program understandings. Government-financed development spending is still suppressed due to weak planning and implementation capacity. As a result, the stock of government cash balance at end-June was little changed from the beginning of the year, against a programmed decline of about SI$40 million. The program target on the net credit to government (NCG) at end-June was also met by a comfortable margin (Table 3).

[1] The program cash balance is defined as the government's gross cash balance less unpaid payment orders and unpresented checks.

[2] Total new appropriations were SI$150 million (2.6 percent of GDP) compared to the program, mainly to cover additional wage costs unveiled by a new payroll accounting system, higher-than-anticipated election costs, and cost overruns from chancery construction. In line with program commitments, this additional spending is being offset by a combination of revenue efforts (SI$57 million) and expenditure savings (SI$93 million) coming from a partial retention of temporary spending reservations made in May and expected underspending of the development budget (SMEFP, paragraph 5). The authorities indicated these and earlier spending reservations would not affect priority spending in education and health, including that provided from donor resources.

7. **Structural fiscal measures are being undertaken mostly in keeping with program understandings.**

- **Tax compliance continues to be strengthened through more aggressive enforcement, audit, and collection efforts.** Total collection of tax arrears in 2010—reported at around SI$7 million through June—is expected to reach SI$15 million this year. However, customs duty collections remain weak, partly due to depressed noncapital imports but also because of delays in appointing a deputy customs comptroller charged with enforcement (now expected by year-end). Staff urged the authorities to remain vigilant in enforcement, including custom clearance of log exports, and minimize the use of discretionary exemptions, in keeping with observance of the end-June benchmark implemented on notifying Parliament annually of all tax and customs exemptions.

- **However, policy action on adjusting the taxable price of log exports fell short of program expectations.** The end-September benchmark called for no less than 85 percent of the formula-based price from October 1, 2010 (US$93 per cubic meter based on the government's determined value calculator) and a quarterly phase-in thereafter under an automatic adjustment mechanism to achieve the full formula-based price from July 1, 2011. Citing political constraints, the government announced a price increase in mid-October from US$83 to US$90 (82 percent of the October 2010 formula-based price) for the last quarter of 2010 (with effect from October 1) and to US$98 for the first half of 2011. Although the revenue impact of this deviation should be minimal in 2010, staff reiterated the need for a fully transparent regime aimed at maximizing government revenues from valuable timber resources. In this regard, the authorities indicated they remain committed to adopting such a regime for logging, mining, and fisheries under a new natural resource tax framework being developed with IMF technical assistance (TA) (a June 2011 program benchmark).

- **Progress is being made in implementing other fiscal-related benchmarks.** In September, Parliament passed amendments to the new Customs Valuation Act clarifying valuation methods, with implementation expected by year end. Draft amendments to the Customs and Excise and Income Tax Acts aimed at legalizing exemption criteria and guidelines and merging exemption committees are also being prepared. Since these amendments cannot be submitted to Parliament until it reconvenes in early 2011, the authorities will now seek Cabinet approval by end-December 2010. Teachers, the police force, and all line ministries have been incorporated into a new payroll accounting system, but the reconciliation of the recorded payrolls is still ongoing. The authorities are also preparing a stand-alone Public Finance Act incorporating fiscal responsibility provisions.

- **Strengthening public financial management (PFM) remains a key priority.** A World Bank-led Public Expenditure Review is ongoing, focused on improving budget formulation and spending prioritization. A joint donor budget support review (led by the Asian Development Bank (AsDB) and European Union) in August 2010 noted steady progress strengthening PFM and improving budget management. The authorities have also made good progress in collecting data on health and education spending, particularly those financed by budget support, with more comprehensive reconciliation and reporting awaiting completion of work over the next year on a new chart of accounts and budget reporting system. Efforts to compile data on nonappropriated development expenditure are ongoing, with the UNDP now installing a system for recording aid flows, although it will still rely on regular reporting by development partners.

Solomon Islands: Grants by Donors 1/
(in SI$ millions)

	2009 Est.
Regional Assistance Mission to Solomon Islands 2/	469
Australian Agency for International Development	177
New Zealand Agency for International Development	210
Taiwan, Province of China	90
Japan 3/	23
European Union	161
Asian Development Bank	37
World Bank	16
Other donors	9
Total	1,192

Sources: CBSI, and data provided by donors.
1/ Includes appropriated grants of SI$255 million in the budget.
2/ Includes only contributions by Australia.
3/ Excludes Japan International Cooperation Agency.

8. **The authorities agreed the 2011 budget would be formulated consistent with program commitments to ensure that public finances remain on a sustainable path.** This would entail targeting a fiscal surplus of about 2¼ of GDP in 2011 so as to further build up the cash balance to a minimal cover of two months of forward recurrent spending by end-2011. To align the budget with the new government's policy priorities, final passage of the 2011 budget is expected to be delayed until March 2011. To ensure the budget process is well guided, the authorities issued a circular in late October (as a prior action for completing first review under the SCF arrangement) setting out a revised budget calendar. The circular authorizes spending for the first four months of 2011 equivalent to the 2010 appropriations level, which is consistent with next year's targeted fiscal surplus. On the revenue side, in addition to continued administration and enforcement efforts, new revenues are expected to come from gold production, which should help defer declining logging duties.[3] Staff also pointed to the low level of petroleum taxation as a potential revenue source, although the authorities saw any tax increase as difficult to absorb because of high fuel costs. In expenditure areas, budget priorities are expected to be aligned with social and infrastructure needs. Staff urged limiting the growth of recurrent spending, in particular the wage bill and parliamentary entitlements, to ensure adequate resources were available for high-impact

[3] These revenues are expected to be equivalent to around ½ percent of GDP in 2011, mainly export duties and Pay-As-You-Earn (PAYE) tax.

outlays to consolidate fiscal gains and help achieve development objectives.[4] Staff also urged the authorities to reallocate a portion of the unspent development budget in 2010 to the new government-donor National Transport Fund for use over the medium term to address infrastructure deficiencies.

B. Monetary, Exchange Rate, and Financial Sector Policies

9. **Monetary conditions have eased further as a result of strong external inflows and policy accommodation.** In the face of these inflows, the Central Bank of Solomon Islands (CBSI) has continued to accumulate foreign reserves and effectively maintain a *de facto* peg vis-à-vis the U.S. dollar. As a result, the end-June target for NIR was met comfortably and was at an estimated US$200 million at end-September, against an indicative target of US$141 million (Table 4). Lacking tools to effectively sterilize these inflows, reserve money has risen dramatically in the past year. However, credit demand remains sluggish, with growth at less than 2 percent (y/y) in August (the latest available figure) owing to weak domestic demand. The end-June target for NDA of the CBSI was also met, largely due to a sharp decline in NCG by the CBSI. Broad money growth has been moderate given limited multiplier effects. In addition, bank lending rates remain sticky and interest spreads large, possibly symptomatic of elevated levels of credit risks and lack of competition in the banking system.

10. **The CBSI agreed to monitor conditions closely and strengthen its operational framework to facilitate an orderly exit from its accommodative stance, as necessary.** In view of still heightened external vulnerability, they agreed to adjust upward the NIR targets by about US$40 million for the remainder of the program. However, as economic prospects improve and credit demand rises, staff urged the CBSI to allow greater exchange rate flexibility, as a pre-emptive move, and to stand ready to mop up excess liquidity, in order to preserve macroeconomic stability. To strengthen the available tools for liquidity management, the CBSI will further refine its liquidity forecasting framework and issue guidelines on the auction of treasury and CBSI bills for conducting open market operations, with the latter a modified program benchmark by end-December 2010 based on recent IMF technical assistance (TA).[5] At the same time, the CBSI plans to issue guidelines to introduce a statutory reserve requirement and new standing facilities to anchor monetary operations and avoid an overshooting of interest rates.[6] It is also considering easing stringent overnight

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[4] To strengthen governance and accountability, Taiwan, Province of China will suspend its support of the Rural Development Constituency Fund (RCDF) from 2011 and instead channel these resources to development-related projects. Currently, proceeds in the RCDF are distributed to each parliamentarian for use in the home district. Total funding (including the government's contribution) are expected to reach SI$105 million in 2010.

[5] The original program benchmark was on finalizing an issuance plan for CBSI bills.

[6] The current liquid asset ratio will be replaced by a reserve requirement system by end-2010.

foreign exchange position limits on banks and exchange controls to facilitate private foreign exchange related transactions.[7]

11. **Financial sector health is slowly improving, with the authorities taking further steps to strengthen the supervisory and regulatory framework.** Recent financial soundness indicators confirm that the banking system is well-capitalized and highly profitable, with nonperforming loans (NPLs) stabilizing (as a share of total bank assets) following an earlier rise, in part stemming from new loan accounting and classification standards adopted in 2009. The CBSI is in the process of moving from a compliance-based to risk-based supervisory approach, as it begins a new round of on-site examinations of commercial banks toward year-end, with IMF TA. In addition, the CBSI in partnership with the Australian Prudential Regulatory Authority recently completed an on-site examination of the National Provident Fund (NPF), which highlighted declining profitability and lack of managerial autonomy. The authorities agreed that reforming the NPF, the largest pool of financial savings in the country, is a priority. To this end, the government will amend the NPF Act to incorporate an independent governance structure for the NPF aimed at minimizing political interference in its operations and investment decisions. Since wider stakeholder consultations are needed for this reform, the authorities requested modification of the end-December benchmark to accommodate a two-stage process, with the government now committed to Cabinet endorsement of a reform plan for the NPF by end-December 2010 (program benchmark) and parliamentary submission of a set of amendments to the NPF Act by end-June 2011 (a new program benchmark).

Solomon Islands: Core Financial Soundness Indicators 1/

	2008	2009	2010	
			March	June
Capital adequacy:				
Regulated capital to risk-weighted assets	22.6	22.0	21.4	28.4
Tier 1 capital to risk-weighted assets	18.3	15.6	24.7	22.8
Nonperforming loans, net of provisions to capital	7.9	9.3	16.3	13.1
Asset quality:				
Nonperforming loans to total gross loans	2.7	3.8	7.0	6.1
Earnings and profitability:				
Return on average assets	10.4	5.9	5.4	5.2
Return on average equity	68.6	31.6	30.2	28.3
Net interest income to gross income	50.2	47.2	48.3	48.1
Noninterest expenses to gross income	34.3	43.5	39.8	40.3
Liquidity:				
Liquid assets to total assets (liquid asset ratio)	10.3	33.4	37.7	40.9
Liquid assets to short-term liabilities	28.3	67.4	57.7	61.9

Source: Central Bank of Solomon Islands.
1/ Commercial banks only, as of end-period.

C. Other Issues

12. **Financing.** The government is expected to receive budget support in the form of grants during 2010–11. The European Union intends to disburse €15 million by end-2010 under its Vulnerability-FLEX Instrument, which should help reconstitute government cash reserves and strengthen the overall fiscal position. In addition, the AsDB is expected to

[7] The current ceiling on banks' overnight foreign exchange position is SI$5 million, which effectively forces them to sell most foreign exchange to the CBSI to reduce excess holdings. There have been no new foreign exchange restrictions or intensification of existing restrictions since the beginning of the program period.

disburse the second tranche (US$5 million) of its budget support program in the second quarter of 2011.

13. **Debt management.** Further steps are being taken to strengthen debt management. In view of progress made in strengthening debt sustainability and settling debt arrears, the World Bank's International Development Association changed the status of the Solomon Islands from high "red light" (high risk) to "yellow light" (medium risk) in July 2010, consistent with the result of the joint Bank-Fund Debt Sustainability Analysis. The move was in keeping with continued progress made under the Honiara Club Agreement (HCA) in normalizing external debt obligations. In September 2010, the authorities repaid the remaining arrears to the European Investment Bank, with confirmation on final debt resolution expected by year end.[8] With assistance from the World Bank, they have now also initiated a planned five-year review of the HCA, with a view to facilitating better access to concessional borrowing over the medium term.

14. **Safeguards assessment.** The IMF Safeguards Assessment was completed in October 2010. As a signal of its commitment to implementing safeguard measures, two new program benchmarks have been added: (i) fully constituting the CBSI Board by end-December 2010 to improve oversight of central bank operations; and (ii) publishing the opinion rendered by an international audit firm on the CBSI audit results and the IFRS-based financial statements, beginning with the 2010 accounts by end-June 2011 to increase overall transparency. The CBSI has also incorporated the recommended changes in computing reserve money, in order to standardize the reporting of NDA of the CBSI under the IMF-supported program.

15. **Statistical policy.** The authorities remain committed to improving macroeconomic statistics to aid the formulation of effective policies and better monitor outcomes. In the context of the program, progress has been made in strengthening and reporting of fiscal data, with work on *GFSM*-compliant statistics awaiting formulation of a new chart of accounts. On the other hand, limited progress has been made toward finalizing official national income account estimates for 2007–09, despite considerable IMF TA. The authorities have agreed to complete and publish these estimates by end-June 2011 (a new program benchmark), with support of a new technical advisor in the National Statistics Office.

III. Staff Assessment

16. **Fiscal policy.** The authorities' efforts in adhering to program fiscal targets are commendable, as the main anchor to macroeconomic stability. Stronger cash and budget management have facilitated smoother fiscal operations than in the recent past, supported by improved inland revenue administration and expenditure monitoring and control. While the program benchmark on logging price adjustment was not met, staff consider the actions taken

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[8] Under the HCA, which was signed by the government and four major external creditors in 2005, the Solomon Islands is expected to pursue grants and other overseas development assistance until it receives "green light" status from the World Bank's IDA.

sufficient in meeting the program's revenue targets in 2010, but look for further steps to be taken in strengthening transparency in the context of ongoing work on a new natural resource tax regime. Looking ahead, ensuring the 2011 budget is consistent with program commitments is necessary to consolidate earlier gains. Longer-term fiscal sustainability will be best ensured by working with development partners to further strengthen tax policy and revenue administration, cash and debt management, and budget processes and expenditure prioritization. To this end, staff welcome the government's continued commitment to rationalizing tax and customs exemptions and adopting fiscal responsibility provisions. The clearance of the remaining external arrears and ongoing review of the HCA also send an important signal toward future borrowing capacity and debt sustainability.

17. **Monetary and exchange rate policies.** The CBSI should stand ready to act if demand-led inflationary pressures were to emerge. In this regard, strengthening the tools for liquidity management is critical. The balance of payments impact of easing foreign exchange restrictions should also be closely monitored along with other external developments. Greater exchange rate flexibility should be pursued, as necessary, to cushion against exogenous shocks and maintain a comfortable level of international reserves.

18. **Financial sector policy.** The banking sector remains well-capitalized and highly profitable. With stability concerns starting to ease, the CBSI should focus on ways of improving operating efficiencies and risk management in the financial system, which could facilitate a market-based reduction in large interest rates spreads in the Solomon Islands. Improving governance and investment decisions of the NPF by amending the NPF Act to ensure a professional, independent management is critical to maximizing member benefits and maintaining financial viability over the long term.

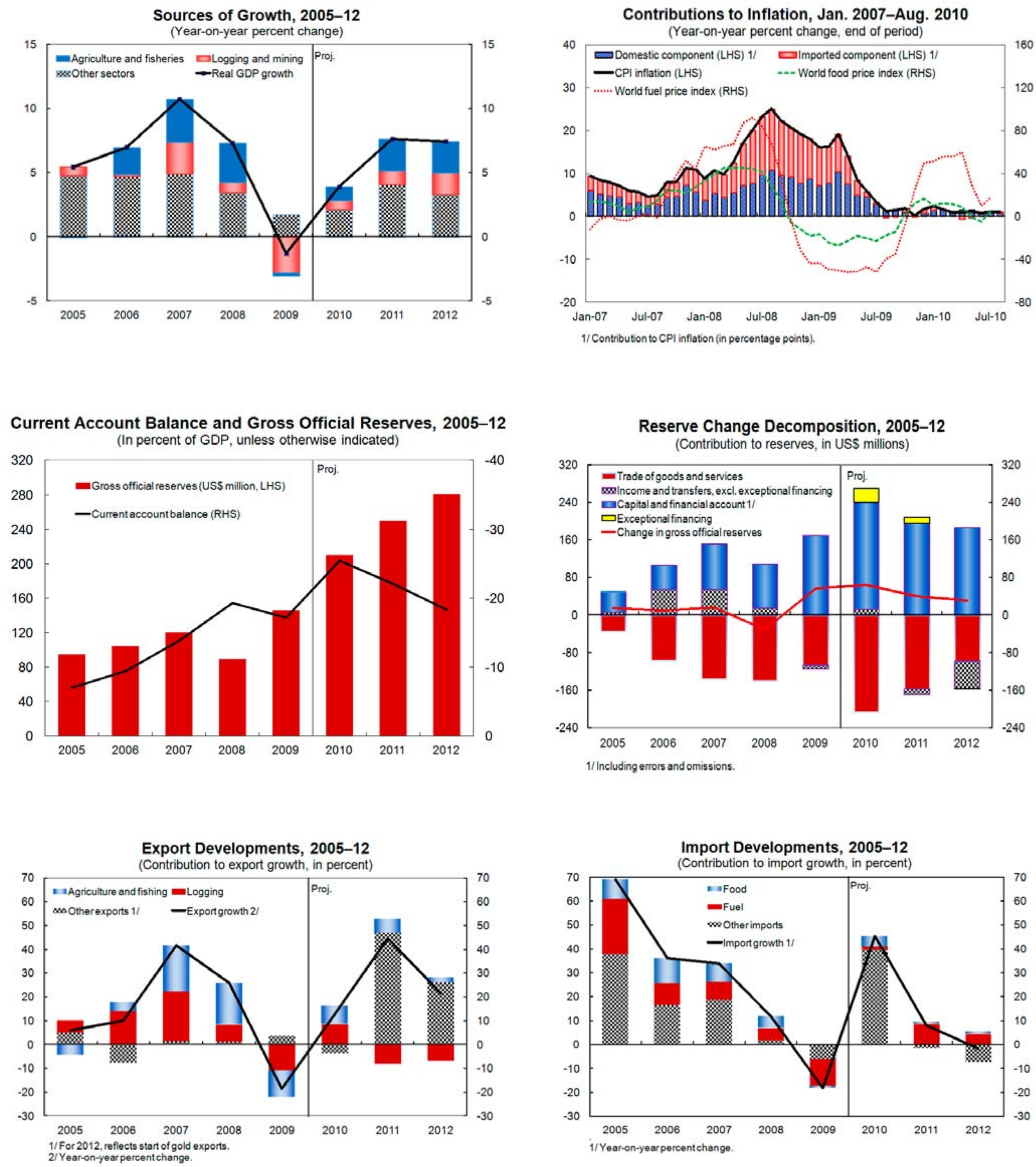
19. **Risks.** The new government will need to remain vigilant over policy directions to ensure macroeconomic stability, with the fiscal position still highly vulnerable to shocks given the limited buildup so far in cash reserves and financing availability. Maintaining these reserves, in the face of political demands on and weak controls over the budget, necessitates broad consensus on scope and direction of structural fiscal reforms. A sharper-than-expected decline in logging production and weakening of global recovery could affect government revenues and export receipts, although new mining-related activity should fill likely losses as timber supplies drop, if consensus can be reached on a strong resource tax regime. Excess liquidity in the banking system and commodity price pressures continue to pose inflationary risks.

20. **Program overview.** The authorities' achievement in meeting the program's performance criteria and benchmarks is commendable. Strong adherence to the program would help anchor macroeconomic policy and address structural weaknesses, and in this regard, staff welcome the new government's commitment to implementing the program agreed with the previous government. As completion of the first review of the SCF is expected to be earlier than foreseen, staff support the authorities' request to make the second

disbursement under the arrangement available earlier than the originally scheduled and rephasing of the disbursements (Table 5).

21. Based on the performance under the program and the authorities' commitment to implementing the program going forward, staff recommend the completion of the first SCF review.

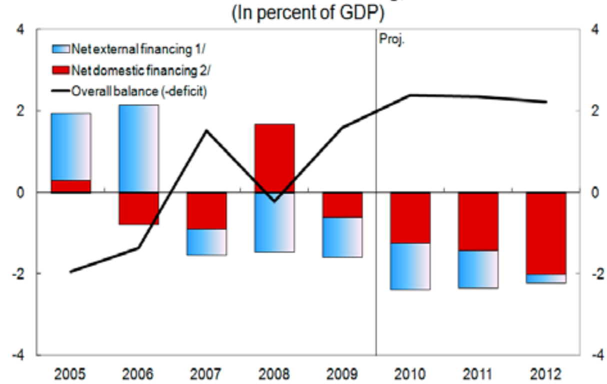
Figure 1. Solomon Islands: Macroeconomic Developments



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

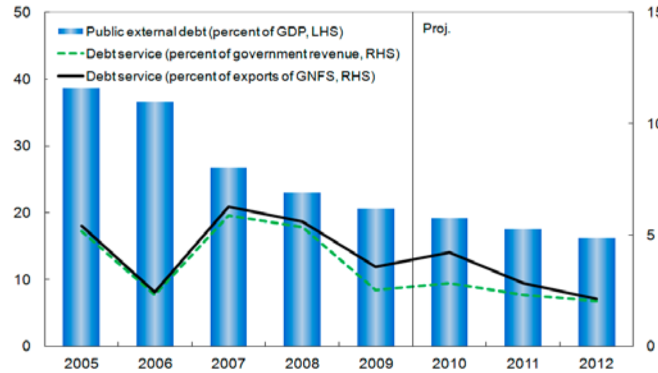
Solomon Islands: Macroeconomic Developments (concluded)

Fiscal Balance and Financing, 2005–12
(In percent of GDP)

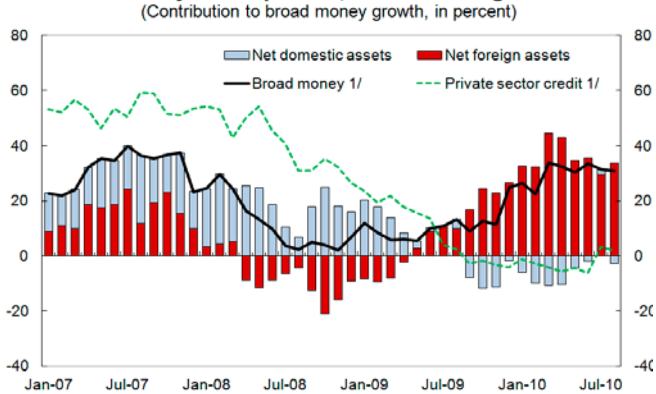


1/ Between 2005–07, includes debt forgiveness.
2/ Includes privatization receipts.

Public External Debt, 2005–12

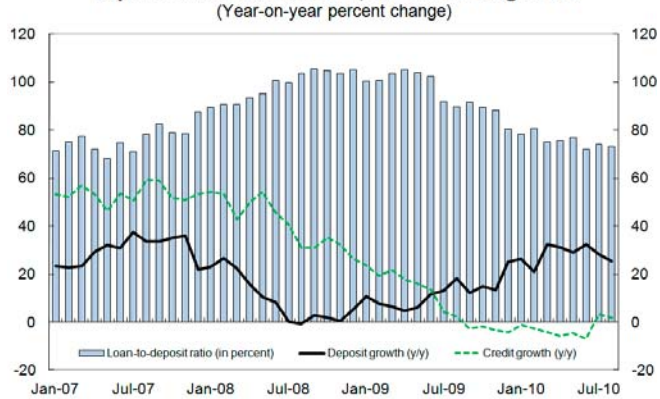


Monetary Developments, Jan. 2007—Aug. 2010
(Contribution to broad money growth, in percent)

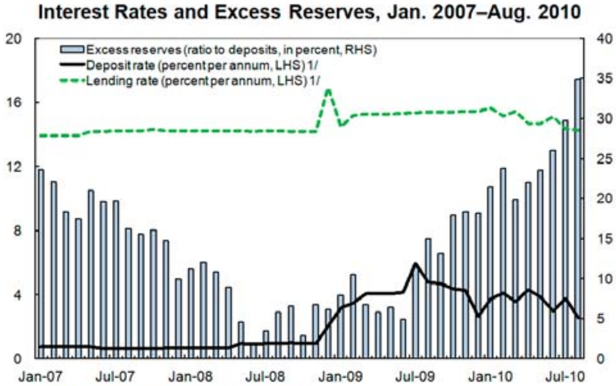


1/ Year-on-year percent change.

Deposit and Credit Growth, Jan. 2007–Aug. 2010
(Year-on-year percent change)

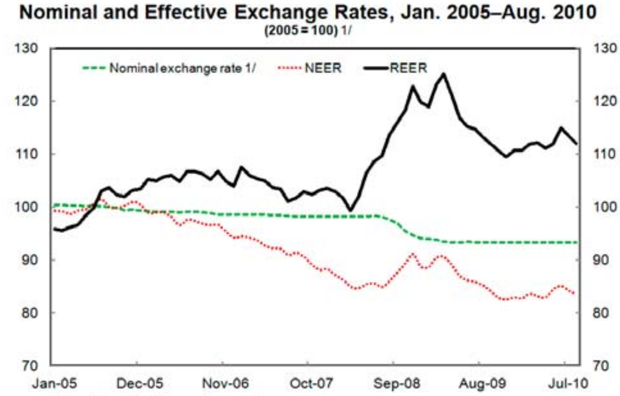


Interest Rates and Excess Reserves, Jan. 2007–Aug. 2010



1/ Weighted average rate of the commercial banks.

Nominal and Effective Exchange Rates, Jan. 2005–Aug. 2010
(2005 = 100) 1/



1/ Based on U.S. dollar exchange rate.

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

Table 1. Solomon Islands: Selected Economic Indicators, 2008-11

Nominal GDP (2009): US$663 million (estimate)
Population (2009): 518 thousand (estimate)

	2008	2009	2010			2011
		Est.	June	Prog.	Rev. Prog.	Proj.
			Est.	Proj.		
Growth and prices (percentage change)						
Real GDP	7.3	-1.3	…	3.4	3.9	7.6
Of which : non-mining real GDP	7.0	-1.5	…	3.3	4.0	5.1
CPI (period average)	17.4	7.1	1.3	4.8	1.5	4.0
CPI (end of period)	18.1	1.8	0.8	6.5	2.9	4.2
GDP deflator	4.0	8.1	…	2.1	2.3	2.8
Nominal GDP (in SI$ millions)	5,004	5,339	…	5,581	5,679	6,286
Per capita GDP (in US$)	1,274	1,279	…	1,269	1,327	1,437
Per capita GNI (in US$)	1,086	1,037	…	958	1,084	1,112
Central government operations (percent of GDP)						
Total revenue and grants	43.8	49.8	24.2	51.8	54.0	53.7
Revenue	27.3	27.5	13.0	27.9	28.5	29.6
Grants	16.5	22.3	11.2	23.9	25.5	24.1
Total expenditure	44.0	48.2	22.3	49.4	51.6	51.3
Recurrent expenditure	23.9	25.6	13.3	26.7	28.1	26.9
Development expenditure	18.4	23.1	9.7	22.4	23.1	24.1
Unrecorded expenditure 1/	1.8	-0.4	-0.7	0.4	0.4	0.3
Overall balance	-0.2	1.6	1.9	2.4	2.4	2.3
Foreign financing (net)	-1.5	-1.0	-0.4	-1.0	-1.2	-0.9
Domestic financing (net)	1.7	-1.4	-1.5	-1.8	-1.4	-1.4
Privatization receipts	0.0	0.8	0.0	0.4	0.2	0.0
Central government debt (percent of GDP, unless otherwise indicated) 2/	32.3	28.7	…	26.8	25.8	22.7
Domestic debt	9.3	8.0	…	6.7	6.6	5.1
External debt	23.0	20.6	…	20.2	19.2	17.6
(In US$ millions, end of period)	143.6	136.7	…	133.1	134.9	137.0
Monetary and credit (percentage change, end-year data)						
Credit to private sector	26.5	-4.2	-6.3	12.2	1.0	15.0
Broad money	6.9	24.7	33.5	7.0	24.9	15.0
Reserve money	-2.3	62.5	122.5	-0.5	49.2	14.6
Interest rate - deposit (percent per annum)	2.0	2.7	3.0	...	…	...
Interest rate - lending (percent per annum)	17.0	15.4	15.1	...	...	...
Balance of payments (in US$ millions, unless otherwise indicated)						
Current account balance	-124.4	-113.5	-57.3	-202.5	-179.1	-172.3
(Percent of GDP)	-19.3	-17.1	…	-30.1	-25.4	-22.1
Exports of goods and nonfactor services	269.5	234.3	133.9	211.1	255.3	342.4
(Percentage change)	20.6	-13.1	…	-4.2	9.0	34.1
Imports of goods and nonfactor services	408.8	341.3	213.5	417.6	461.7	499.2
(Percentage change)	14.0	-16.5	…	35.5	35.3	8.1
Overall balance	-31.0	56.4	36.5	11.8	54.6	30.7
Gross official reserves (in US$ millions, end of period) 3/	89.5	146.0	182.5	167.5	209.9	250.0
(In months of next year's imports of goods and nonfactor services)	3.1	3.8	4.4	4.8	5.0	6.0
Exchange rate (SI$/US$, end of period)	8.00	8.06	8.06	…	...	...
Real effective exchange rate (period average, 2005 = 100)	110.1	115.9	112.1	...	...	...
Nominal effective exchange rate (period average, 2005 = 100)	86.9	86.3	83.7	...	...	...

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

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

2/ Includes disbursements under an IMF-supported arrangement.

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

Table 2. Solomon Islands: Balance of Payments, 2008-12 1/

(In millions of U.S. dollars)

	2008	2009	2010		2011	2012
		Est.	Proj.	Rev. Proj.	Proj.	
Current account balance	-124.4	-113.5	-202.5	-179.1	-172.3	-155.3
Trade balance for goods	-82.4	-75.8	-177.9	-163.3	-108.7	-45.0
Exports	210.5	163.4	144.7	184.1	266.3	323.3
Logs	110.3	88.1	71.4	101.8	87.8	70.9
Fish	22.6	16.5	18.5	18.9	21.9	25.8
Minerals	2.6	3.7	3.9	3.8	89.5	153.7
Other	75.0	55.1	50.9	59.6	67.1	72.9
Imports	-292.9	-239.2	-322.6	-347.4	-375.0	-368.3
Food	-63.5	-60.4	-65.2	-70.6	-73.0	-76.5
Fuel	-84.4	-51.9	-68.1	-55.0	-85.3	-102.1
Other	-145.0	-126.9	-189.2	-221.8	-216.7	-189.8
Trade balance for services	-56.9	-31.2	-28.7	-43.1	-48.0	-53.0
Exports	59.0	70.9	66.4	71.2	76.2	80.9
Imports	-115.9	-102.1	-95.0	-114.3	-124.2	-133.9
Income balance	-95.0	-125.3	-165.2	-128.6	-176.7	-204.5
Current transfers balance 2/	109.9	118.8	169.3	156.0	161.1	147.2
Of which : Official transfers, net	90.5	120.8	147.3	155.4	160.5	144.9
Capital account balance	14.3	26.8	12.9	23.8	26.7	24.1
Financial account balance	88.6	139.4	201.3	209.9	176.3	162.0
Direct investment balance	91.1	115.1	207.0	212.6	184.5	166.7
Portfolio investment balance	3.3	1.2	…	0.0	0.0	0.0
Other investment balance 3/	-5.9	23.1	-5.7	-2.7	-8.3	-4.7
Errors and omissions	-9.5	3.7	0.0	0.0	0.0	0.0
Overall balance	-31.0	56.4	11.8	54.6	30.7	30.8
Financing	31.0	-56.4	-11.8	-54.6	-30.7	-30.8
Change in gross reserves (- = increase)	31.0	-56.4	-21.5	-63.9	-40.0	-30.7
IMF	…	…	9.7	9.3	9.3	-0.1
Memorandum items:						
Current account (in percent of GDP)	-19.3	-17.1	-30.1	-25.4	-22.1	-18.3
(excluding mining-related capital imports)	…	…	-21.6	-15.2	-13.3	-12.6
(excluding net official transfers)	-33.3	-35.3	-51.9	-47.5	-42.7	-35.4
Net international reserves 3/	89.5	146.0	157.8	200.6	231.3	262.1
Gross official foreign reserves 3/ 4/	89.5	146.0	167.5	209.9	250.0	280.6
In months of next year's goods and nonfactor services	3.1	3.8	4.8	5.0	6.0	6.7
In months of nonmining-related imports of GNFS	…	4.5	5.5	6.3	7.2	8.3
Gross external public debt (in percent of GDP)	23.0	20.6	20.2	19.2	17.6	16.3
External public debt service (in percent of GDP)	2.3	1.3	1.3	1.5	1.0	1.0
Nominal GDP	645.8	662.8	…	…	…	…

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

1/ Incorporates the authorities' revision of historical data, including new formula for f.o.b/c.i.f conversion, new estimates of reinvested earnings and donor grants, and reclassification of current and capital transfers.

2/ For 2010-11, includes additional donor support expected under the IMF-supported arrangement.

3/ Includes the SDR allocations made by the IMF in 2009.

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

Table 3. Solomon Islands: Summary of Fiscal Accounts, 2008-11

	2008	2009	2010					2011
		Est.	Budget	Jan.-Jun.		Jan.-Dec.		Proj.
				Prog.	Est.	Prog.	Rev. Prog.	
	(In millions of Solomon Islands dollars)							
Total revenue and grants	2,193	2,659	3,139	1,260	1,352	2,894	3,064	3,373
Total revenue	1,366	1,467	1,644	703	724	1,559	1,616	1,860
Tax revenue	1,199	1,272	1,430	612	685	1,357	1,446	1,668
Income and profits	442	540	519	255	271	567	576	664
Goods and services	425	423	569	211	248	470	536	601
International trade and transactions	332	309	342	145	166	320	334	403
Of which: Tax on logging	209	162	…	48	103	149	202	196
Other revenue	167	196	214	91	39	202	170	193
Grants	827	1,192	1,495	558	628	1,335	1,448	1,513
Development grants	717	1,054	1,322	442	471	993	1,058	1,187
Recurrent budget grants	109	138	173	115	157	173	222	301
Additional donor budget support 1/	0	0	0	0	0	168	168	25
Expenditure	2,204	2,574	3,153	1,260	1,244	2,758	2,929	3,226
Of which: appropriated 2/	1,486	1,521	1,831	818	773	1,765	1,871	2,039
Recurrent expenditure	1,195	1,366	1,536	715	742	1,490	1,596	1,690
Compensation of employees	453	511	487	258	280	515	580	605
Interest payments	56	34	34	16	12	31	31	29
Other recurrent expenditure	686	820	1,015	442	450	944	985	1,056
Development expenditure	921	1,231	1,617	535	540	1,248	1,313	1,516
Of which: Domestically financed	204	178	295	93	70	255	255	329
Unrecorded expenditure 3/	88	-22	0	10	-38	20	20	20
Current balance	281	240	281	103	139	242	242	471
Overall balance	-11	85	-14	0	107	135	135	147
(excluding recurrent and additional budget grants)	-121	-53	-187	-115	-49	-206	-255	-179
Total financing	11	-85	14	0	-107	-135	-135	-147
Foreign (net)	-73	-53	-53	-40	-25	-53	-65	-58
Domestic (net)	84	-77	47	40	-83	-102	-80	-89
Banking system	92	-64	55	43	-88	-94	-88	-80
Central bank	96	-25	80	25	-61	-105	-105	-55
Commercial banks	-4	-39	-25	18	-27	11	17	-25
Nonbank	-8	-13	-8	-3	6	-8	8	-9
Privatization receipts 4/	0	45	20	0	0	20	10	0
	(In percent of GDP)							
Total revenue and grants	43.8	49.8	56.2	22.6	24.2	51.8	54.0	53.7
Total revenue	27.3	27.5	29.5	12.6	13.0	27.9	28.5	29.6
Tax revenue	24.0	23.8	25.6	11.0	12.3	24.3	25.5	26.5
Income and profits	8.8	10.1	9.3	4.6	4.9	10.2	10.1	10.6
Goods and services	8.5	7.9	10.2	3.8	4.4	8.4	9.4	9.6
International trade and transactions	6.6	5.8	6.1	2.6	3.0	5.7	5.9	6.4
Of which: Tax on logging	4.2	3.0	…	0.9	1.8	2.7	3.6	3.1
Other revenue	3.3	3.7	3.8	1.6	0.7	3.6	3.0	3.1
Grants	16.5	22.3	26.8	10.0	11.2	23.9	25.5	24.1
Expenditure	44.0	48.2	56.5	22.6	22.3	49.4	51.6	51.3
Of which: appropriated 2/	29.7	28.5	32.8	14.7	13.9	31.6	33.0	32.4
Recurrent expenditure	23.9	25.6	27.5	12.8	13.3	26.7	28.1	26.9
Compensation of employees	9.1	9.6	8.7	4.6	5.0	9.2	10.2	9.6
Interest payments	1.1	0.6	0.6	0.3	0.2	0.6	0.5	0.5
Other recurrent expenditure	13.7	15.4	18.2	7.9	8.1	16.9	17.3	16.8
Development expenditure	18.4	23.1	29.0	9.6	9.7	22.4	23.1	24.1
Of which: Domestically financed	4.1	3.3	5.3	1.7	1.2	4.6	4.5	5.2
Unrecorded expenditure 3/	1.8	-0.4	0.0	0.2	-0.7	0.4	0.4	0.3
Current balance	5.6	4.5	5.0	1.9	2.5	4.3	4.3	7.5
Overall balance	-0.2	1.6	-0.2	0.0	1.9	2.4	2.4	2.3
(excluding recurrent and additional budget grants)	-2.4	-1.0	-3.3	-2.1	-0.9	-3.7	-4.5	-2.8
Total financing	0.2	-1.6	0.2	0.0	-1.9	-2.4	-2.4	-2.3
Foreign (net)	-1.5	-1.0	-1.0	-0.7	-0.4	-1.0	-1.2	-0.9
Domestic (net)	1.7	-1.4	0.8	0.7	-1.5	-1.8	-1.4	-1.4
Privatization receipts 4/	0.0	0.8	0.4	0.0	0.0	0.4	0.2	0.0
Memorandum items:								
Nominal GDP (in SI$ millions)	5,004	5,339	5,581	5,581	5,581	5,581	5,679	6,286
Gross cash balance (in SI$ millions) 5/	137	106	…	59	97	206	206	261
Program cash balance (in SI$ millions) 6/	…	47	…	10	39	167	167	242

Sources: Data provided by the Solomon Islands authorities; and IMF staff estimates and projections.
1/ Reflects prospective additional budget support from donors in 2010-11.
2/ Expenditure appropriated or recorded in the government's recurrent and development estimates, including supplemental budget appropriations.
3/ Includes changes in the stock of unpaid payment orders and unpresented checks (+ = reduction) and the statistical discrepancy.
4/ For 2009, includes receipts from the sale of a new telecommunication license of SI$31 million.
5/ Sum of government deposits in the core cash balance accounts.
6/ The gross cash balance minus unpaid payments orders and unpresented checks.

Table 4. Solomon Islands: Summary Accounts of the Banking System, December 2008 - December 2011 1/

	2008	2009	2010				2011		
	Dec.	Dec.	Jun.	Aug.	Sep.	Dec.	Mar.	Jun.	Dec.
			Est.		Prog.	Rev.Prog.	Rev.Prog.	Prog.	Proj.
	(In millions of Solomon Islands dollars, end of period)								
Central Bank of Solomon Islands (CBSI)									
Net foreign assets (NFA)	708	1,051	1,314	1,409	1,019	1,492	1,535	1,600	1,739
Net international reserves (NIR)	716	1,177	1,434	1,530	1,141	1,618	1,661	1,726	1,865
Other NFA	-9	-126	-120	-121	-121	-126	-126	-126	-126
Net domestic assets (NDA) 2/	-262	-328	-386	-328	-327	-411	-401	-411	-501
Net claims on central government	-52	-77	-139	-55	-63	-182	-144	-182	-237
Claims	138	124	121	120	120	119	119	119	119
Deposits	190	201	259	175	183	301	263	301	356
Other items (net)	-210	-250	-248	-273	-264	-229	-257	-229	-264
Reserve money	446	724	927	1,080	692	1,080	1,134	1,189	1,238
Currency in circulation	273	326	358	358	320	397	410	424	450
Bank deposits	166	389	563	703	368	678	721	762	785
Other deposits	7	9	6	20	5	5	3	3	3
Other depository corporations									
NFA of commercial banks	137	181	203	154	148	219	237	241	232
Assets	143	184	218	172	150	236	240	243	250
Liabilities	6	2	16	17	2	17	2	2	18
NDA of commercial banks	888	927	878	771	1,022	989	1,003	1,031	1,161
Net claims on central government	90	51	24	-3	65	68	63	58	43
Claims	116	125	113	113	103	94	89	84	69
Deposits	26	74	89	116	38	26	26	26	26
Claims on the private sector	1,274	1,219	1,214	1,210	1,317	1,232	1,272	1,320	1,416
Other items (net)	-476	-343	-360	-436	-360	-311	-332	-347	-298
Reserves and vault cash	188	410	599	732	397	704	750	806	814
Deposits	1,213	1,519	1,680	1,658	1,567	1,912	1,990	2,077	2,207
Depository corporations survey									
NFA of the banking system	845	1,233	1,517	1,563	1,167	1,711	1,772	1,840	1,971
Central bank	708	1,051	1,314	1,409	1,019	1,492	1,535	1,600	1,739
Other depository corporations	137	181	203	154	148	219	237	241	232
NDA of the banking system	625	600	492	443	694	578	602	620	660
Net claims on central government	38	-26	-115	-58	2	-114	-81	-124	-194
Claims on the private sector 3/	1,278	1,224	1,219	1,213	1,322	1,236	1,277	1,325	1,421
Other items (net)	-690	-598	-613	-712	-629	-544	-594	-581	-567
Broad money (M3)	1,470	1,833	2,008	2,006	1,861	2,288	2,374	2,460	2,632
M1	898	1,130	1,286	1,348	1,123	1,410	1,463	1,516	1,622
Currency outside banks	250	305	322	328	290	372	381	380	421
Demand deposits	648	824	965	1,019	833	1,039	1,082	1,136	1,201
Savings and time deposits	572	703	722	658	738	878	911	944	1,010
	(Annual percentage change, unless otherwise indicated)								
Reserve money	-2.3	62.5	122.5	104.6	37.2	49.2	44.2	28.2	14.6
Credit to the private sector	26.5	-4.2	-6.3	1.8	9.5	1.0	4.7	8.7	15.0
Broad money	6.9	24.7	33.5	30.8	21.8	24.9	22.4	22.5	15.0
NFA of the banking system 4/	-9.1	26.4	35.5	33.6	5.4	26.1	18.6	16.1	11.4
NDA of the banking system 4/	16.0	-1.7	-2.0	-2.8	16.4	-1.2	3.8	6.4	3.6
Memorandum items:									
Money multiplier	3.3	2.5	2.2	1.9	2.7	2.1	2.1	2.1	2.1
Loan to deposit ratio (in percent)	105.0	80.3	72.3	73.0	84.1	64.4	63.9	63.6	64.2
Interest rates (percent per annum)									
Deposit rate 5/	2.0	2.7	3.0	2.6	…	…	…	…	…
Lending rate 5/	17.0	15.4	15.1	14.3	…	…	…	…	…
Program targets									
NIR of CBSI (in US$ millions)	90	146	178	190	141	201	206	214	…
NDA of CBSI (in SI$ millions)	-262	-328	-386	-328	-327	-411	-401	-411	…

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

1/ Based on the program exchange rate of SI$8.06 per US$.

2/ The end-2009 estimates and 2010-11 revised program projections incorporate the changes in the measurement of reserve money following the recommendations of the IMF Safeguards Assessment.

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

4/ Contribution to year-on-year broad money growth, in percentage points.

5/ Weighted average of different maturities.

Table 5. Solomon Islands: Reviews and Disbursement Under the Standby Credit Facility

Date	Amount of Disbursement		Condition
	In percent of quota	In SDR	
June 2, 2010	30	3,120,000	Approved Fund arrangement
November 15, 2010	30	3,120,000	Completion of the first review and observance of end-June 2010 performance criteria
May 15, 2011	30	3,120,000	Completion of the second review and observance of end-December 2010 performance criteria
November 15, 2011	30	3,120,000	Completion of the third review and observance of end-June 2011 performance criteria
Total	120	12,480,000	

Source: IMF.

APPENDIX I—LETTER OF INTENT

Ref. RF457/5/5 November 1, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Mr. Strauss-Kahn:

The Solomon Islands has benefited from sound macroeconomic policies that underpin the Government's economic reform program, which is being supported by a Standby Credit Facility (SCF) arrangement. Economic recovery is underway, with inflation remaining low and foreign reserves rising. The fiscal position has improved and monetary conditions remain supportive. Our aim is to continue to ensure a policy framework is in place that promotes strong, sustainable, and equitable growth in a stable macroeconomic environment, helping to advance our poverty alleviation efforts.

We remain committed to implementing the program described in the May 14, 2010 Memorandum of Economic and Financial Policies (MEFP). While the thrust of our policies are as described in the MEFP, we are providing the attached Supplemental MEFP (SMEFP), which updates the near-term outlook, requests modification of end-December performance criteria to reflect recent developments, sets the end-June 2011 performance criteria, and reaffirms policy commitments for the rest of the program period. We have also made minor amendments to the attached Technical Memorandum of Understanding to strengthen program monitoring.

Given the success of the program to date and the observance of all end-June 2010 program targets, we request the completion of the first review and release the corresponding disbursement. As the expected timing of this request is earlier than originally foreseen, we are requesting a rephasing of the disbursements such that resources under the SCF be available on or after November 15, 2010, subject to successful completion of the first review. In view of this, we are also proposing that the second review of the program take place on or after May 15, 2011 and the third review on or after November 15, 2011. The program will continue to be monitored through quantitative performance criteria and indicative targets, structural benchmarks, and semi-annual reviews (see SMEFP Tables 1 and 2).

We intend to maintain a close policy dialogue with the Fund, and stand ready to take additional measures, as appropriate, to ensure the achievement of the government's macroeconomic objectives under the SCF. We will consult with the Fund in advance on the adoption of these measures or on any revisions to policies contained in the SMEFP, in accordance with the Fund's policies on such consultation. Furthermore, we will provide the Fund with any information it may request on policy implementation, as necessary to achieve program objectives. We also authorize the publication of this Letter of Intent and the attached SMEFP.

Sincerely yours,

/s/

Hon. Gordon Darcy Lilo, MP
Minister of Finance and Treasury
Ministry of Finance and Treasury

/s/

Denton Rarawa
Governor
Central Bank of Solomon Islands

Attachments: Supplemental Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding

APPENDIX I—ATTACHMENT I

SUPPLEMENTAL MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

This memorandum serves as a supplement to the May 14, 2010 Memorandum of Economic and Financial Policies (MEFP), which sets out the Government of Solomon Islands reform program, as set out in the Government of Solomon Island's arrangement under the Standby Credit Facility (SCF). We reaffirm the government's commitments to achieve the main program objective of building a path back to strong, sustainable, and equitable growth in a low inflation environment, providing a sound basis to advance poverty alleviation efforts. Our program's core elements remain strengthening government finances, improving monetary operations, safeguarding international reserves, and containing financial sector risks. Updated quantitative targets and structural policies underpinning the program are summarized in Tables 1 and 2.

I. MACROECONOMIC PERFORMANCE AND OUTLOOK

1. **Macroeconomic performance has been generally favorable in 2010**. We expect growth to be around 4 percent—slightly higher than projected in the original MEFP, mainly due to log exports. Inflation has declined to the low single digits, mostly because of subdued fuel and food prices, but a modest increase is expected by end-2010 to about 3 percent (year-on-year), reflecting recent global pressures on nonoil commodity prices. The external current account deficit is now projected to be 25–26 percent of GDP in 2010, with a more favorable trade balance and larger grants disbursements than originally programmed. Combined with private inflows related to new mining and telecommunication investments, we expect gross official reserves to rise to US$210 million by end-2010 (five months of next year's imports of goods and nonfactor services).

2. **We remain cautious in our near-term outlook, given global growth is expected to moderate slightly in 2011.** Real GDP growth in the Solomon Islands is projected to rise to 7½ percent in 2011, now factoring in the resumption of gold production by mid-year but also a moderation in logging production volumes, owing to sustainability issues. Inflation is projected to be 4–5 percent over the medium term. Given new gold exports, the current account deficit should further narrow to 22–23 percent of GDP in 2011, although unexpected pressures could emerge from stronger imports depending on the overall strength and breadth of economic recovery. Under the current outlook, gross official reserves are projected to further rise to US$250 million by end-2011 (six months of imports).

II. PROGRAM POLICIES

A. Fiscal Policy

3. **Overall fiscal performance in 2010 has been broadly in line with program targets.** Total revenue collection has been on track and recurrent spending has been restrained. As a result, the government's net cash balance, adjusting for unpaid payment orders and unpresented checks, declined by SI$8 million in the first half of the year, against a

programmed decrease of SI$40 million. By a broader measure of our commitment to fiscal discipline, net credit to the central government stayed well below the program ceiling. We continue to monitor the situation closely through our three-month forward cash forecast, with cash pressures projected to ease in the fourth quarter of 2010, factoring in expected disbursement of large European Union budget support under its Vulnerability-Flex Instrument.

4. **We remain committed to sound fiscal management, focused on strengthening the overall cash position and enabling smooth budget operations.** An overall fiscal surplus of 2.4 percent of GDP (including grants) remains our target in 2010, consistent with increasing the net cash balance by a minimum of SI$120 million during the current fiscal year. In keeping with this target, we withdrew spending warrants equivalent to SI$116 million in May 2010 and temporarily reserved other expenditure warrants to conserve cash, while protecting priority outlays. In October 2010, we also raised the taxable price of log export to US$90 per cubic meter (82 percent of the formula-based price) for the period October–December 2010 and to US$98 per cubic meter for the period January–June 2011. While the price increase in October was slightly less than that committed under the program, we believe this and the planned increase in January 2011 are consistent with meeting program revenue targets. At the same time, we remain committed to developing a stable, predictable, and nondiscretionary tax regime on logging, which we plan to embody in a new natural resource tax framework under development.

5. **In response to a supplementary budget passed by Parliament in September 2010, we have taken the necessary corrective measures to ensure fiscal targets are met.** The supplement, which totaled SI$150 million (2.6 percent of GDP) compared to the original program (or SI$178 million compared to the 2010 budget), was necessitated by spending appropriations not provisioned and contingency warrants not raised in the original budget. It mainly arose from (i) an upward adjustment to payroll spending by SI$65 million compared to the program level (SI$93 million compared to the original budget), mainly due to a revised base in 2009 arising from a new financial management information system (FMIS) and payroll accounting system upgrades; and (ii) additional appropriations of SI$85 million mainly to cover higher-than-expected election costs, overseas student grants, and foreign mission construction. Offsetting measures have been taken as follows:

- Revenue increases (SI$57 million) derive mainly from overperformance of inland revenues in the first half of the year against program targets, in part because of ongoing improvements to income tax and GST administration, with about SI$50 million in additional collections expected in 2010 (including tax arrears of around SI$15 million). The rest would come from higher-than-expected export duties, namely from logging, netting out projected shortfalls in import duties and nontax revenues.

- Expenditure savings (SI$93 million) come mostly from a partial retention of temporary spending reservations made earlier this year (SI$50 million) and expected underspending of development budget (SI$29 million). However, we are still committed to increasing development spending during the program period to address social and infrastructure needs. To this end and as part of upcoming budget

deliberations for FY2011, Cabinet will give consideration to making a contribution to the new National Transport Fund (NTF) as a way of ensuring funding is available for important transport infrastructure projects and to leverage additional donor funding.

6. **We are also in the process of formulating the FY2011 budget consistent with our program commitment of ensuring public finances remain on a sustainable path.** As a new government, we have defined policy priorities consistent with achieving an overall fiscal surplus of 2¼ percent of GDP in 2011. In line with this target, we will further build up government cash balances to a minimal cover of two months of forward recurrent spending by end-2011. To ensure that the 2011 budget is formulated through a fully consultative process, we intend to present it for final passage in the first quarter of next year.

- Revenue efforts will be boosted by further broadening our tax base, including through fully operationalizing a new accounts modernization system, collecting additional tax arrears, and rationalizing tax and customs exemptions. In addition, we have amended the Customs Valuation Act to clarify valuation methods, with implementation expected by year-end (a December 2010 program benchmark). Despite an unforeseen delay, we now expect to have a Deputy Customs Comptroller in place by the beginning of 2011, who will focus on enforcement. With the expected commencement of gold exports by mid-year, new export duties, Pay-As-You-Earn (PAYE) collections, and withholding taxes on dividends are expected to accrue to the budget.

- Expenditure plans will be underpinned by a budgetary process that takes into account stakeholder views, including line ministries, provincial governments, civil society, and development partners. In this context, we will follow a well-defined budget process, anchored by issuance of a ministerial circular detailing a budget calendar, as a prior action for completion of the first review of the SCF arrangement. In view of the need to reprioritize spending to meet critical social and infrastructure needs, we will limit growth in the government wage bill and parliamentary entitlements. Real spending increases, rather, will focus on donor-supported health and education outlays and high-impact capital expenditure, including those possibly emanating from the NTF.

7. **We continue to make progress in implementing structural fiscal reforms under the program.** Enforcement actions have been taken against several large taxpayers to collect income tax and customs-related arrears (a continuous program benchmark). We also are making timely progress in incorporating all line ministries into the new payroll accounting system and in legalizing exemption criteria and guidelines and merging exemption committees governed by the Customs and Excise and Income Tax Acts (December 2010 program benchmarks). Since necessary amendments to these acts cannot be submitted to Parliament until it reconvenes in early 2011, we will seek cabinet approval of them by end-December 2010. The work with the World Bank on Public Expenditure Review is ongoing, with the outcome expected to improve budget formulation and spending prioritization. We will continue our efforts to compile and report data on nonappropriated development expenditure, through inter-ministerial cooperation, and to collect and monitor priority

spending. To these ends, we intend to redouble our efforts to strengthen cash management and budget execution by incorporating a new chart of accounts into the FMIS and ascribing to International Public Sector Accounting Standard (IPSAS) cash-based accounting standards.

8. **We are also committed to taking steps to ensure long-term fiscal sustainability.** We expect ongoing IMF technical assistance will help us develop a framework for a natural resource tax regime by June 2011 (a program benchmark). Until this regime is in place, we will refrain from signing new mineral leasing agreements. Complementing this action will be efforts to push ahead with a comprehensive mining policy, with the assistance of the World Bank, which promotes the sound and transparent development of the mining sector. More broadly, we are preparing a stand-alone Public Finance Act that will incorporate fiscal responsibility provisions (a June 2011 program benchmark). Among other things, these provisions, as a complement to new financial instructions already built into the current act, would provide a description of the annual- and medium-term budget strategy chosen to obtain fiscal objectives and ensure regular publication of reports on the attainment of these objectives. Finally, working with the Asian Development Bank and World Bank, we remain committed to accounts strengthening at the state-owned enterprises and annual production of audited financial statements, as a first line of defense against incurring unforeseen contingent liabilities.

B. Monetary, Exchange Rate, and Financial Sector Policies

9. **The rapid increase in international reserves and corresponding buildup in domestic liquidity continue to pose a challenge to monetary policy operations.** Given limited tools to sterilize the monetary impact of rising net international reserves (NIR), reserve money has increased rapidly since end-2009. However, we do not see signs of overheating so far, as private sector credit growth remains sluggish and banks' excess reserves continue to build at the CBSI. Nonetheless, we are fully aware that this excess liquidity might create inflationary pressures once lending activities pick up, as we expect later this year as economic recovery gains steam.

10. **We will continue to monitor monetary conditions closely, with the Central Bank of Solomon Islands (CBSI) standing ready to tighten monetary policy, as necessary.** To strengthen our liquidity management framework, we intend to issue guidelines on the auction of CBSI and treasury bills for open market operations by end-December 2010 (a program benchmark). At the same time, we will replace the current liquid asset requirement with a statutory reserve requirement, giving banks a more efficient means for managing their liquidity. We also plan to issue guidelines to introduce new standing facilities to establish an interest rate corridor to anchor monetary operations.

11. **Exchange rate policy will remain focused on maintaining an adequate level of foreign reserves while supporting the recovery in the economy.** In light of recent balance of payment developments, we are revising upward the targets for NIR to capture some of the overperformance as an added cushion for external shocks. At the same time, we will ease limits on commercial banks' overnight holding of foreign exchange and reduce the maximum exchange rate margins they are allowed to charge customers to facilitate foreign exchange

related transactions. The authorities also stand ready to bestow greater exchange rate flexibility, as necessary, to help achieve the program's target on NIR.

12. **We remain committed to enforcing new prudential regulations and strengthening financial sector soundness.** The banking sector remains well capitalized and profitable, although the application of the new prudential guidelines has indicated greater asset quality risks. To move toward a more risk-based supervisory approach, we are conducting on-site examinations of one bank by end-December 2010, and plan to extend the coverage to another by end-June 2011. In regard to the National Provident Fund (NPF), an on-site examination was conducted jointly by the CBSI and Australian Prudential Regulation Authority in September 2010. Following this important exercise, we will prepare a policy paper outlining proposed reforms to the NPF for Cabinet to endorse by end-December 2010 (a program benchmark). This paper is expected to recommend an independent governance structure for the NPF aimed at strengthening fund management and investment decisions. Following Cabinet's endorsement of the policy paper, the Attorney General's office will use it to draft the necessary amendments to the NPF Act, which we will submit to Parliament by end-June 2011 (a program benchmark).

III. Other Issues

13. **External debt and arrears:** We have initiated work on the five-year review of the Honiara Club Agreement, with assistance from the World Bank, which we aim to use to update development partners and other potential creditors on our progress in reducing debt levels and eliminating external arrears, as a step toward possible future concessional borrowing. Complementing this move is the recent "yellow light" status inferred by the World Bank's International Development Association, consistent with the medium risk of debt distress noted in the update of the Debt Sustainability Analysis done at the time of approval of the SCF arrangement.

14. **Safeguards assessment:** The CBSI is committed to implementing the recommendations of the IMF Safeguards Assessment by fully constituting the CBSI board (a new December 2010 program benchmark) and publishing annually the opinion rendered by the international audit firm on CBSI audit results and the IFRS-based financial statements, beginning with the 2010 accounts (a new June 2011 program benchmark).

15. **Statistical issues:** In view of the need to provide a broad measure of economic activity, we will publish national income accounts for 2007–09 by June 2011 (a new program benchmark).

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

	12/31/2009		6/30/2010			9/30/2010	12/31/2010		3/31/2011		6/30/2011
	Est.	Rev.	PC	PC with adjustors	Est.	IT	PC	Rev.PC	IT	Rev.IT	PC
Performance criteria 1/											
Net international reserves (NIR) of the Central Bank of Solomon Islands (CBSI) (floor, eop stock, in millions of U.S. dollars (US$)) 2/ 3/	146	146	147	154	178	141	158	201	160	206	214
Net domestic asset (NDA) of the CBSI (ceiling, eop stock, in millions of Solomon Islands dollars (SI$)) 4/ 5/	-367	-328	-332	-393	-424	-327	-472	-411	-447	-401	-411
Net credit to central government (NCG) (ceiling, cumulative change from the beginning of the year, in millions of SI$) 6/	-77	-77	40	40	-83	22	-102	-80	31	31	-14
New nonconcessional external debt maturing in more than one year, contracted or guaranteed by the public sector (ceiling, eop stock since the beginning of the program, in millions of US$) 7/	…	…	0	0	0	0	0	0	0	0	0
New nonconcessional external debt maturing in one year or less, contracted or guaranteed by the public sector (ceiling, eop stock since the beginning of the program, in millions of US$) 7/	…	…	0	0	0	0	0	0	0	0	0
Accumulation of new external payment arrears by the public sector (ceiling, eop stock since the beginning of the program, in millions of SI$) 7/	…	…	0	0	0	0	0	0	0	0	0
Central government program cash balance (floor, cumulative change from the beginning of the year, in millions of SI$) 6/	…	…	-37	-37	-8	-13	120	120	-33	-33	10
Memorandum items:											
Budget support from bilateral and multilateral donors other than IMF (cumulative change from the beginning of the year, in millions of US$), program level.	28	28	17	…	25	24	53	59	8	11	28
Outstanding stock of Solomon Islands government (SIG) treasury bills, excluding restructured government bonds (end-period stock, in millions of SI$), program level.	…	…	…	…	…	…	…	40	…	40	40

1/ Evaluated at the program exchange rate.

2/ The adjustors are specified in the Technical Memorandum of Understanding (TMU) and include: the floor on NIR will be adjusted upward (downward) by the amount of budget support from bilateral and multilateral donors (excluding IMF) in excess (short) of the program level.

3/ The end-June 2010 NIR target is adjusted upward by US$7.5 million, the amount of budget support from bilateral and multilateral donors (excluding IMF) during January-June 2010 in excess of the program level.

4/ The adjustors are specified in the TMU and include: the ceilings on NDA will be adjusted downward (upward) by the amount of budget support from bilateral and multilateral donors (excluding the IMF) in excess (short) of the program level.

5/ The end-June NDA target is adjusted downward by SI$60.6 million, the amount of budget support from bilateral and multilateral donors (excluding IMF) during January-June 2010 in excess of the program level. Following the recommendations of the IMF Safeguards Assessment, the revised end-2009 NDA as well as the revised program targets for end-December 2010 and end-March 2011 and new targets for end-June 2011 incorporate the recommended changes in the measurement of reserve money. Such changes, however, are not applied in measuring the June 2010 NDA outcome to make it consistent with the June 2010 PC, which was set before the changes were made.

6/ The adjustors are specified in the TMU and include: the floor on central government program cash balance will be adjusted downward and the ceiling on NCG will be adjusted upward by the stock amount of budget support from bilateral and multilateral donors (excluding the IMF) short of the program level; the floor on the program cash balance will be adjusted upward (downward) by the stock of government treasury bills, excluding restructured government bonds, in excess (short) of the program level.

7/ These performance criteria are applicable on a continuous basis.

Table 2. Solomon Islands: Prior Action and Structural Benchmarks

Actions	Date	Macroeconomic criticality	Status
	Prior Action		
Issue a ministerial circular detailing the new budget calendar for 2011.		To strengthen the budgetary process.	
	Benchmarks		
Apply full enforcement actions to collect income tax arrears.	Continuous	To strengthen revenue administration and collections.	In progress, with several prosecutions under way.
Issue a ministerial circular authorizing annual notification to the Public Accounts Committee of the nature and cost of all tax and customs exemptions granted.	June 30, 2010	To promote fiscal transparency and enhance revenue collections.	Met (June 25, 2010).
Issue monetary policy regulations revising the lender of last resort provisions of the Central Bank of Solomon Islands (CBSI).	June 30, 2010	To safeguard the stability of the financial sector.	Met (June 30, 2010).
Adopt an automatic adjustment mechanism for the price of logs, with the determined price adjusted to no less than 85 percent of the formula-based price from October 1, 2010, and a quarterly phase-in thereafter to achieve full consistency with the formula-based price from July 1, 2011.	September 30, 2010	To promote fiscal transparency, enhance revenue collections, and ensure sustained output.	Not fully met. The price for October-December 2010 was increased from US$83 per cubic meter to US$90 (equivalent to 82 percent of the formula based price), and for January-June 2011 to US$98. The tax regime for logging is expected to be embodied in a new natural resource tax framework under development.
Amend the Customs Valuation Act and issue new implementation guidelines by end-2010, bringing the act into full effect.	December 31, 2010	To strengthen customs administration and revenue collections.	The amendment was passed by Parliament on September 28, 2010. The full act is expected to be implemented by end-2010.
Receive cabinet approval of amendments to the Customs and Excise and Income Tax Acts legalizing exemption criteria and guidelines, including full disclosure requirements, and merging existing exemption committees into a unified committee structure.	December 31, 2010	To promote fiscal transparency and enhance the efficiency of revenue collections.	In progress, with draft amendments under preparation by the Attorney General's office. Cabinet approval, instead of parliamentary submission, is sought by end-December 2010, since the Parliament is not expected to reconvene before early 2011.
Incorporate all line ministries and employees into the new payroll accounting system.	December 31, 2010	To strengthen expenditure oversight and control.	In progress, with teachers, the police force, and all line ministries under the establishment incorporated and a reconciliation of recorded payrolls under way.
Issue auction guidelines for CBSI and treasury bills.	December 31, 2010	To broaden monetary instruments.	The regulations are being drafted with IMF technical assistance (TA).
Constitute fully the membership of the CBSI Board of Directors.	December 31, 2010	To strengthen governance of the CBSI.	New benchmark.
Obtain Cabinet endorsement of a reform plan to the National Provident Fund (NPF) strengthening governance and oversight.	December 31, 2010	To improve the long-term financial viability of the NPF and reduce fiscal risks.	A policy paper outlining proposed reforms to the NPF is being prepared. Wider consultations with the stakeholders are being conducted to strengthen ownership of the proposed reforms.
Submit to Parliament a revised National Provident Fund (NPF) Act incorporating the reform plan endorsed by the Cabinet.	June 30, 2011	To improve the long-term financial viability of the NPF and reduce fiscal risks.	New benchmark.
Formulate a resource tax regime, consistent with IMF technical assistance recommendations.	June 30, 2011	To broaden the tax base and increase revenue transparency.	IMF TA in this area is ongoing.
Draft fiscal responsibility provisions to be incorporated into either a Fiscal Responsibility Act or an amended Public Finance and Audit Act.	June 30, 2011	To strengthen budget management and ensure fiscal sustainability.	The Public Finance and Audit Act is being separated into two stand-alone acts, with fiscal responsibility provisions to be built into a stand-alone public finance act..
Publish finalized national income accounts for 2007-09.	June 30, 2011	To strengthen macroeconomic indicators.	New benchmark, with a technical advisor employed to assist the National Statistics Office with improving statistical policy, including on the national income accounts.
Publish the opinion rendered by the international audit firm on the CBSI audit results and the IFRS-based financial statements, beginning with the 2010 financial statements.	June 30, 2011	To improve transparency of the CBSI.	New benchmark.

APPENDIX I—ATTACHMENT II

SOLOMON ISLANDS: TECHNICAL MEMORANDUM OF UNDERSTANDING

1. The program will be monitored through quantitative performance criteria, indicative targets, structural benchmarks, and reviews. This memorandum sets out the definitions for quantitative performance criteria and indicative targets under which performance under the program will be assessed. Monitoring procedures and reporting requirements are also specified.

I. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS

2. Performance criteria for end-December 2010 and end-June 2011 and indicative targets for end-March 2011 have been established with respect to:

- Floors on the level of net international reserves (NIR) of the Central Bank of Solomon Islands (CBSI);
- Ceilings on the level of net domestic assets (NDA) of the CBSI;
- Ceilings on the level of net credit to the central government (NCG); and
- Floors on the central government cash balance.

3. Performance criteria applicable on a continuous basis have been established with respect to:

- Ceilings on the contracting and guaranteeing by the public sector of new medium- and long-term nonconcessional external debt;
- Ceilings on the contracting and guaranteeing by the public sector of new short-term nonconcessional external debt; and
- Ceilings on accumulation of new external payment arrears by the public sector.

II. INSTITUTIONAL DEFINITIONS

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

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

III. MONETARY AGGREGATES

6. **Valuation.** Foreign currency-denominated accounts will be valued in Solomon Islands dollar (SI$) at the program exchange rate of SI$8.06 per U.S. dollar, as of end-2009. Foreign currency accounts denominated in currencies other than the U.S. dollar and

monetary gold will first be valued in U.S. dollars at actual exchange rates and gold prices used by the CBSI, respectively, before they are converted to Solomon Islands dollars.

A. Reserve Money

7. Reserve money consists of currency issued by the CBSI (excluding CBSI holdings of currency) and all transferable deposits held at the CBSI.

B. Net International Reserves of the CBSI

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

9. NIR will be calculated as gross international reserves (GIR) less international reserve liabilities. For program monitoring purposes, the stock of foreign assets and foreign liabilities of the CBSI, as reported in Solomon Islands dollars, shall be valued at program exchange rate in U.S. dollars, as described on paragraph 6.

10. GIR of the CBSI are defined as the sum of:

- Foreign currency assets in convertible currencies held abroad and as vault cash that are under the direct and effective control of the CBSI and readily available for intervention in the foreign exchange market or the direct financing of balance of payments imbalances and are of investment grade or held with an investment-grade institution.
- The reserve position of the Solomon Islands in the IMF;
- Holding of SDRs; and
- Monetary gold.

Excluded from the definition of GIR are:

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

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

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

C. Net Domestic Assets of the CBSI

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

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

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

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

D. Net Credit to the Central Government

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

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

IV. Fiscal Aggregates

A. Cash Balance of the Central Government

16. A floor applies to the program cash balance of the central government. The floor on the program cash balance will be adjusted downward by the amount of budget support from bilateral and multilateral donors (excluding IMF) in short of the programmed level. The floor on the program cash balance will also be adjusted upward (downward) by the stock of government treasury bills, excluding restructured government bonds, in excess (short) of the program level of SI$40 million.

17. The program cash balance of the central government is defined as the gross cash balance minus the total amount of unpaid payment orders and unpresented checks.

18. The gross cash balance is defined as the sum of government deposits, which are not in any way encumbered or pledged as collateral or used as a guarantee against government incurred liabilities, in the following accounts:

- In CBSI: Solomon Islands Government (SIG) Revenue Account, SIG Funded Development Account, SIG Debt Servicing Account;
- In Australia New Zealand Bank: SIG Creditors Account; Payroll Imprest Account, and Airport Service Fees Account;
- In Bank of South Pacific: Provincial Revenue Holding Account, SIG Inland Revenue Account, Sub Treasury Gizo Account, and Sub Treasury Auki Account; and
- Donor funded budget support accounts that are created by and under control of the government.

V. External Debt

A. Medium- and Long-Term External Debt

19. A ceiling applies to the contracting and guaranteeing by the public sector of new nonconcessional borrowing with nonresidents with original maturities of more than one year. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. This applies to private debt for which official guarantees have been extended and which, therefore, constitutes a contingent liability of the public sector. The public sector comprises the central government, the CBSI, nonfinancial public enterprises, and other official entities.

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

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

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

23. For program purposes, a debt is concessional if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the net present value (NPV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The NPV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the currency specific commercial interest reference rates (CIRRs), published by the Organization for Economic Cooperation Development (OECD). For debt with a maturity of at least 15 years, the 10-year-average CIRR will be used to calculate the

NPV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the 6-month average CIRR will be used. To both the 10-year and 6-month averages, the same margins for differing repayment periods as those used by the OECD would continue to be added (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more).

B. Short-Term External Debt

24. A ceiling applies to the contracting and guaranteeing by the public sector of new nonconcessional borrowing with nonresidents with original maturities of up to and including one year. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. This applies to private debt for which official guarantees have been extended and which, therefore, constitute a contingent liability of the public sector.

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

26. Excluded from the ceiling are (i) debts classified as international reserve liabilities of the CBSI; (ii) debts incurred to restructure, refinance, or prepay existing debts, to the extent that such debt is incurred on more favorable terms than the existing debt and up to the amount of the actually restructured/refinanced/prepaid debt; (iii) SI$-denominated treasury bills and bonds and CBSI and Bokolo bills held by nonresidents; and (iv) normal import financing. A financing arrangement for imports is considered to be "normal" when the credit is self-liquidating.

VI. External Payment Arrears

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

VII. Data Provision

28. The data listed below will be provided for monitoring performance under the program based on data templates agreed with Fund staff. Under each section, reporting responsibilities are indicated in parentheses. Weekly data are requested for submission to Fund staff by the end of the following week. Monthly and quarterly data are requested for submission within six weeks of the end of the observation period. The authorities have committed to using the best available data, so that any subsequent data revisions will not lead to a breach of quantitative performance criteria or benchmarks. All revisions to data will be promptly reported to Fund staff.

A. Monetary Data (CBSI)

On a weekly basis:

- Daily exchange rates, both buying and selling rates, of the Solomon Islands dollar against the U.S. dollar, including the official, interbank, and parallel market exchange rates;

- Stock of NIR and sales and purchases by the CBSI in the foreign exchange markets;

- Stock of reserve money and its components; and

- Treasury bill auction reports.

On a monthly basis:

- Financial corporations' survey, including the balance sheet of CBSI, the consolidated balance sheet of ODCs, and the consolidated balance sheet of OFCs;

- Liquid asset ratios and/or reserves requirement of the commercial banks;

- Interest rates, including average interbank rate, bank deposit rates, and bank lending rates;

- A detailed breakdown of NCG from the CBSI, commercial banks and other ODCs, and OFCs;

- Foreign exchange cash-flow of the CBSI, including donor disbursements; and

- Balances of each central government account specified in Section IV. A., as recorded or collected by the CBSI.

B. Fiscal Data (Ministry of Finance and Treasury (MoFT))

On a monthly basis:

- Consolidated accounts of the central government, including detailed data on:

    - Revenue, including tax and nontax revenues, and recurrent and development grants included in the consolidated budget;

    - Recurrent expenditure, including payroll, goods and services, and other recurrent outlays, including those funded by donor support;

    - Other recurrent charges of the Ministry of Education and Ministry of Health, separating spending funded by donor support;

    - Debt service payments, classified into amortization and interest payments on (i) domestic debt, (i) external debt, (iii) domestic arrears, and (iv) external arrears; and

- Development expenditure funded by (i) central government of the Solomon Islands, and (ii) foreign grants and loans included in the consolidated budget.

- Detailed financing components of central government's accounts, classified into foreign and domestic sources.

  - Foreign financing includes (i) disbursement and amortization of project and program loans, and (ii) changes in external debt arrears, classified into principal and interest arrears.

  - Domestic financing includes (i) borrowing from and repayment to the CBSI, commercial banks and other ODCs, and OFCs; (ii) changes in deposits at the CBSI, commercial banks and other ODCs, and OFCs; and (iii) privatization receipts and changes in domestic debt arrears, classified into principal and interest arrears.

- Stock of domestic debt, including the outstanding balance of government securities, treasury bills, cash advances, and other debt instruments.

- Balances of each central government account specified in Section IV. A., as recorded by the MoFT.

- Stock of unpaid government payment orders and unpresented checks.

C. External Sector Data (CBSI and MoFT)

On a quarterly basis:

- New external debt obligations contracted and/or guaranteed by the government of the Solomon Islands, CBSI, and other official entities, including details on the amounts, terms, and conditions of each obligation.

- Stock of outstanding external debt at end-month and disbursement, amortization, and interest payments for short-term external obligations contracted or guaranteed by the government or the CBSI by creditor in original currency and U.S. dollars.

- Stock of external debt at end-month and disbursement, amortization, and interest payments for medium- and long-term external obligations contracted or guaranteed by the government or the CBSI by creditor in original currency and U.S. dollars.

- Stock of arrears on the external debt contracted or guaranteed by the government or the CBSI by creditor in original currency and in U.S. dollars at end-month.

On a quarterly basis:

- Balance of payment data, including detailed components of current accounts and capital and financial accounts.

D. Real Sector Data (MoFT, National Statistical Office)

On a monthly basis:

- The monthly consumer price index and a detailed breakdown by major categories of goods and services included in the consumer basket.

ANNEX I. GUIDELINES ON PERFORMANCE CRITERIA WITH RESPECT TO FOREIGN DEBT

Excerpt from Executive Board Decision No. 6230-(79/140), as revised on August 31, 2009

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

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

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

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

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

Statement by Christopher Legg, Alternate Executive Director and Mario Di Maio, Senior Advisor
November 17, 2010

The Solomon Islands met the performance criteria for June and September and there was strong progress on the structural benchmarks in the program.

After beginning recovery during 2010, the pace of growth is expected to accelerate sharply in 2011 to 7½ percent. The early resumption of gold mining will provide a substantial boost to growth. Underlying growth will also strengthen as investment and consumption rebound with stable macroeconomic policy and with the successful transition to the new government.

Following elections a new government was formed in late August. Its economic policy priorities highlight the importance of poverty alleviation through fostering a dynamic private sector, ensuring a fair reward from the use of natural resources, and close cooperation with development partners. In support of these goals the government renewed the Solomon Islands' commitment to the prudent macroeconomic management and the structural reforms supported by the Fund program. The authorities reached understandings on revisions to the fiscal program for the remainder of 2010 with the Fund and look forward to maintaining the close relationship with the Fund that has been established.

The authorities will continue to maintain a prudent approach to monetary policy. Inflation is projected to remain low and stable. International reserves exceeded program targets and now are around seven months of imports. Higher-than-programmed international reserves have been built into the program and reserves are programmed to cover at least six months of imports in 2011. Private credit growth is expected to pick-up modestly over the next year from a very low base. The authorities will keep on developing liquidity management tools to better manage the substantial excess liquidity in the financial system.

The financial system remains stable and banks are well-placed to withstand potential shocks. The authorities are pressing ahead to address the remaining vulnerabilities. Reforms to strengthen the governance and independence of the National Provident Fund – the largest financial institution – are important to safeguard long term financial stability. These reforms remain on track; although the timetable has been pushed back slightly because the Attorney General has concluded that more time is needed for approval by the new government and consultation with those affected.

Fiscal targets were met for June with revenue exceeding program projections. However, some adjustments to the fiscal program for the remainder of 2010 were required to maintain the targeted buildup in cash reserves. Spending on wages was higher than anticipated, mostly as a result of an underestimate of base for the wage bill in 2009. Spending associated with the elections was higher than expected. The previous government made a number of other spending commitments prior to the election, several of which were contractual commitments.

Clearly, these spending increases during 2010 are not a signal of a change in policy direction from the new Government, whose recently-released policy statement underlines the importance of tight spending control and prudent fiscal policy. To reinforce this commitment the authorities have taken the following measures that in their view will lead to the fiscal cash surplus in 2010 exceeding the current targets in the program:

- The budget for the remainder of 2010 continues to be based on conservative assumptions about revenue performance.
- The authorities have committed to reducing spending by more than initially programmed in the remainder of 2010.
- A range of revenue measures including, inter alia, greater collection of land tax, an increase in the determined value of log exports, and the forfeit of a performance bond by the new mobile telecoms operator will add a cushion to the projected fiscal balance for the remainder of 2010.

The authorities are committed to a prudent 2011 budget that meets the objective of achieving the cash buffer established in the program. The budget will be finalized early in 2011 to give sufficient time to ensure spending is aligned with the new government's priorities. For the first part of the year budget execution will be guided by the 2010 budget and is consistent with the fiscal program.

The structural component of the program has also progressed well. The adjustment of the determined value of log export fell marginally short (the adjustment in September was 82 percent of the world log price rather than 85 percent). The impact on revenue is marginal (less than 1 million Solomon Islands dollars or around 0.15 percent of GDP). The government remains committed to ensuring that resources are fairly taxed. To this end it has already adjusted the December 2010 determined value that exceeds the programmed adjustment of 90 percent of the world price based on current projections.

Looking ahead, the authorities consider that it is essential to strengthen the current tax system and provide a firmer legislative basis for improvements in fiscal policy and budget management. Timely provision of Fund technical assistance, including on the resource tax regime, is critical given the substantial pipeline of mining projects. The Solomon Islands is currently engaged in a public expenditure review with assistance from the World Bank. This will inform the authorities' plans to improve the effectiveness of public spending. Together, these elements comprise a strategy that aims to free-up resources to address the large need for investment in infrastructure and poverty alleviation, deal with the likely gradual reduction of donor support in the medium-term, and provide a sound basis for the resumption of concessional public sector borrowing.

In summary, the program remains firmly on track. The new Government demonstrated its commitment to prudent macroeconomic management under the Fund program, notably through challenging decisions to reduce spending during the remainder of 2010 and to increase the determined value of logs in the face of strong sector interest groups. The economic recovery during 2010 is expected to strengthen. Preparations are well in hand to meet the benchmarks in December. The program is not without risks, but these have receded substantially since the approval of the program.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes First Review Under Standby Credit Facility Arrangement with Solomon Islands and Approves US$4.83 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Solomon Islands' economic performance under a program supported by an 18-month Standby Credit Facility (SCF). The completion of the review enables the immediate disbursement of an amount equivalent to SDR 3.12 million (about US$4.83 million), bringing total disbursements under the arrangement to an amount equivalent to SDR 6.24 million (about US$9.66 million).

The SCF arrangement was approved on June 2, 2010 (see Press Release No. 10/223) for an amount equivalent to SDR 12.48 million (about US$19.3 million) or 120 percent of the Solomon Islands' quota.

Following the Executive Board's discussion on Solomon Islands, Mr. Naoyuki Shinohara, Deputy Managing Director and Acting Chair, stated:

“The Solomon Islands has benefitted from sound macroeconomic policies underpinning its economic reform program supported by a Standby Credit Facility arrangement. Program performance has been generally good, and economic prospects have improved with a pickup in exports and lower inflation. Strong adherence to the program and further progress in structural reforms would help anchor macroeconomic stability and lay the foundation for diversification of the economy.

“Fiscal performance has been broadly in line with the program, with strengthened cash and budget management facilitating smoother fiscal operations. Further steps are also being taken to settle external debt arrears under the Honiara Club Agreement. Ensuring that the 2011 budget is consistent with program commitments would help consolidate earlier gains. Longer-term fiscal sustainability will depend on further strengthening revenue administration, cash and debt management, budget processes, and expenditure prioritization. Developing a transparent and predictable tax regime for natural resources and adopting fiscal responsibility provisions, as committed under the program, would also bolster the fiscal framework.

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"Large external inflows have contributed to a higher-than-anticipated buildup in international reserves and a rapid increase in domestic liquidity. Although inflation remains low, the central bank should remain vigilant and stand ready to exit its accommodative policy stance if inflationary pressures intensify.

"Financial sector health is improving but the authorities should continue to focus on enhancing the oversight and risk management of financial institutions. Reforming the National Provident Fund is also important for maintaining financial stability."