

Solomon Islands: 2021 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Solomon Islands



SOLOMON ISLANDS

January 2022

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR SOLOMON ISLANDS

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2021 Article IV consultation with Solomon Islands, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its January 7, 2022 consideration of the staff report that concluded the Article IV consultation with Solomon Islands.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 7, 2022, following discussions that ended on November 5, 2021, 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 December 14, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staff of the IMF and the World Bank.
- A **Statement by the Executive Director** for Solomon Islands.

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

Selected Issues

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



IMF Executive Board Staff Concludes 2021 Article IV Consultation with Solomon Islands

FOR IMMEDIATE RELEASE

Washington, DC – January 21, 2022: On January 7, 2022, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Solomon Islands.

The authorities have enacted strong and timely measures to contain COVID-19, with no record of local transmission thus far. Measures implemented by the government include temporary suspension of all commercial international flights and ban on entry of non-citizens, and strict mandatory quarantine for all returning passengers. At the same time, progress in advancing vaccinations has been relatively slow and should be accelerated to meet the authorities target to allow timely and safe border reopening.

Solomon Islands' economy has been hit hard by the impact of the COVID-19 pandemic. Real GDP contracted in 2020 and growth is estimated to have remained subdued at 0.4 percent in 2021, owing to lower global demand and the impact of containment measures on trade and economic activity. Labor market conditions have deteriorated, and the pandemic is likely to have disrupted progress in poverty reduction and human development. While the unrest in late November 2021 increases downside risks, economic activity is projected to recover gradually and to gain strength as containment measures are relaxed and borders reopened. The fiscal balance is estimated to have increased to 2.9 percent of GDP in 2021, reflecting revenue loss and additional spending in response to COVID-19. Central government debt remained low, but is estimated to have increased to 16.2 percent of GDP in 2021. At end-December 2021, foreign reserves remained robust at about 11.1 months of prospective imports, reflecting inflows from development partners, subdued imports in 2020, and the new allocation of IMF Special Drawing Rights. Inflation remains low (at 2 percent in November 2021) but is expected to increase, reflecting, in part, the impact of higher commodity prices.

Risks to economic activity are tilted to the downside. Any domestic virus transmission could lead to a significant increase in human, as well as economic costs. Additional downside risks include persistent social unrest, negative impact of climate change, and volatile commodity prices. On the upside, a stronger than expected global recovery owing to a faster than expected containment of the virus, a quicker rebound in tourism driven by regional reopening and acceleration in infrastructure investment could spur a stronger recovery.

Executive Board Assessment²

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for their strong and timely response to the pandemic, which prevented a local outbreak. However, they noted that containment measures weighed on economic activity and that pre-existing socioeconomic tensions were aggravated during the pandemic, as indicated by the recent unrest. Against this background, Directors emphasized the importance of

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

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

accelerating vaccination efforts and providing targeted support to the economy in the near-term, while rebuilding fiscal buffers and accelerating structural reforms to diversify the economy as the crisis dissipates.

Directors concurred on the need to entrench a durable recovery through targeted and transparent support to vulnerable households and businesses. Once the pandemic abates, they encouraged rebuilding fiscal buffers to ensure fiscal and debt sustainability through a gradual fiscal consolidation while retaining the debt-based fiscal anchor. On fiscal reforms, Directors welcomed the progress made, and encouraged the authorities to move forward with a comprehensive tax reform, spearheaded by modernizing tax administration and introducing a value added tax. They also underscored the need to establish a medium-term revenue strategy and to prioritize public financial management reforms to maintain fiscal sustainability and improve governance. In this regard, they looked forward to the completion and publication of the audit of pandemic-related expenditures. Directors also encouraged the authorities to identify additional sources of financing, including for achieving the Sustainable Development Goals and climate resilience.

Directors considered that the accommodative monetary policy stance and the current exchange rate regime remain appropriate, and encouraged maintaining a strong reserves buffer to support macroeconomic stability. They emphasized the need to address potential financial sector vulnerabilities proactively and to continue to closely monitor non-performing loans. Directors called for the continuation of the financial sector reforms agenda to increase private sector credit growth and advance financial development and inclusion. Strengthening the AML/CFT framework to mitigate pressures on correspondent banking relationships also remains a priority.

Directors encouraged implementation of structural reforms to support economic diversification and private sector development. Efforts could focus on strengthening human capital, developing quality infrastructure, improving the business environment, and advancing the governance and anti-corruption agendas. In that context, Directors encouraged the authorities to continue to benefit from capacity development by the Fund and development partners.

Selected Economic Indicators, 2017–2026

Per capita GDP (2019): US\$2,215 (p)

Population (2019): 721,455 (p)

Poverty rate (2006): 23 percent

Quota: SDR 20.8 million

	2017	2018	2019 Est.	2020 Proj.	2021	2022	2023	2024	2025	2026
GROWTH AND PRICES										
Real GDP	5.3	3.9	1.2	-4.3	0.4	2.3	3.4	2.9	3.1	3.1
CPI (period average)	0.5	3.5	1.6	3.0	-0.2	3.8	3.5	3.6	3.5	3.5
CPI (end of period)	2.1	3.8	2.7	-2.5	3.1	3.2	3.4	3.5	3.5	3.5
GDP deflator	1.4	2.9	1.3	3.4	4.2	4.5	4.1	4.4	4.2	4.1
Nominal GDP (in SI\$ millions)	11,703	12,522	12,833	12,697	13,290	14,211	15,299	16,442	17,657	18,950
CENTRAL GOVERNMENT OPERATIONS										
Total revenue and grants	39.2	40.4	32.8	33.2	30.9	29.7	30.1	30.7	30.4	30.2
Revenue	30.2	30.5	26.4	24.4	22.3	23.0	24.1	24.9	24.6	24.5
Grants	9.0	9.9	6.4	8.8	8.6	6.7	6.1	5.8	5.8	5.7
Total expenditure	42.1	39.5	33.7	35.6	33.8	32.9	33.9	34.4	34.5	34.6
excluding grant-funded expenditure	33.1	29.6	27.3	26.9	25.2	26.2	27.8	28.6	28.8	28.9
Recurrent expenditure	29.2	29.5	25.6	29.3	26.8	24.2	24.2	24.3	24.4	24.4
Development expenditure	12.9	10.0	8.0	6.4	7.0	8.7	9.7	10.1	10.2	10.2
Unrecorded expenditure	-1.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-2.9	0.9	-0.9	-2.4	-2.9	-3.1	-3.8	-3.7	-4.2	-4.4
Foreign financing (net)	-0.3	-0.1	0.0	1.4	1.5	2.4	2.7	2.3	2.1	2.1
Domestic financing (net)	1.9	-0.8	0.9	1.0	1.4	0.7	1.1	1.4	2.1	2.3
Central government debt 1/	8.4	8.3	8.2	13.1	16.2	18.3	20.7	23.1	25.6	28.3
MACROFINANCIAL										
Credit to private sector	6.4	4.1	6.1	0.3	1.0	4.0	7.0	6.0	5.5	5.0
Broad money	3.5	6.8	-3.1	6.6	3.4	3.6	4.3	4.0	3.8	4.1
Reserve money	7.5	10.6	-7.1	23.0	2.1	2.0	2.1	2.1	1.9	1.8
BALANCE OF PAYMENTS										
Trade balance (goods and services)	-81.7	-67.6	-161.6	-127.4	-184.6	-308.7	-317.5	-291.3	-293.9	-322.9
(percent of GDP)	-5.5	-4.3	-10.3	-8.2	-11.2	-17.5	-16.7	-14.3	-13.4	-13.7
Current account balance	-62.8	-47.8	-154.0	-25.1	-85.2	-219.3	-233.6	-202.1	-200.3	-225.6
(percent of GDP)	-4.2	-3.0	-9.8	-1.6	-5.2	-12.4	-12.3	-9.9	-9.1	-9.6
Foreign direct investment (+ = decrease)	-35.9	-15.9	-28.7	-5.7	-24.1	-50.1	-58.2	-56.5	-57.3	-61.3
(percent of GDP)	-2.4	-1.0	-1.8	-0.4	-1.5	-2.8	-3.1	-2.8	-2.6	-2.6
Overall balance (+ = decrease)	-41.2	-57.4	33.8	-73.1	-39.6	59.6	57.1	33.0	24.4	35.5
Gross official reserves (in US\$ millions, end of period) 2/	576.9	613.1	574.1	660.6	700.3	640.9	588.9	565.7	547.2	513.7
(in months of next year's imports of GNFS)	9.3	9.8	12.4	13.5	10.9	9.0	8.5	8.1	7.5	6.7
EXCHANGE RATE (SI\$/US\$, end of period)										
Real effective exchange rate (end of period, 2010 = 100)	126.4	126.5	127.2	129.7	...	...	...	...	...	...
MEMORANDUM ITEMS:										
Cash balance (in SI\$ millions)	343	311	206	206	104	104	104	104	104	104
in months of recurrent spending	1.5	1.2	0.8	0.8	0.4	0.4	0.4	0.3	0.3	0.3
SIG Deposit Account (In addition to cash balance, in SI\$ millions)	140	140	140	120	120	120	120	120	120	120
Broader cash balance (=Cash balance+ SIG Deposit Account; in SI\$ millions)	483	451	346	326	224	224	224	224	224	224
in months of total spending 3/	1.5	1.5	1.2	1.1	0.8	0.7	0.6	0.6	0.5	0.5
Public domestic debt, including arrears (in SI\$ millions)	193	245	273	452	747	843	1,010	1,244	1,620	2,054

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

1/ Includes disbursements under the IMF-supported programs.

2/ Includes SDR allocations made by the IMF to Solomon Islands in 2009 and in 2021, and actual and prospective disbursements under the IMF-supported programs.

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



SOLOMON ISLANDS

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

December 14, 2021

KEY ISSUES

Context. Strong and timely containment measures have successfully prevented a domestic COVID-19 outbreak but have also weighed on economic activity and aggravated pre-existing socio-economic tensions. Following a contraction in 2020, growth is projected to recover gradually starting this year and to gain strength as containment measures are relaxed and borders re-opened. Elevated pandemic-related uncertainties as well as longstanding social, economic and governance challenges and vulnerability to natural disasters pose headwinds to inclusive growth. Despite strong external buffers, weaker fiscal position increases vulnerability to shocks, while the decline in logging weighs on fiscal revenues and growth prospects.

Main policy recommendations.

- **COVID-19 response.** Pandemic responses, including measures to accelerate vaccinations, should continue. The government should identify additional financing to provide targeted and transparent support to vulnerable households and businesses and continue efforts to avoid any delays in government payments.
- **Fiscal policy.** Post-pandemic policies should focus on rebuilding fiscal buffers to enhance resilience and address spending needs for progress towards Sustainable Development Goals. An effective debt based fiscal anchor can help guide policy. Reforms are needed to improve fiscal governance, advance Public Financial Management, and establish a comprehensive medium-term revenue strategy to maintain fiscal sustainability. Modernizing tax administration and introducing a Value Added Tax are important first steps towards comprehensive tax reforms.
- **Monetary and financial sector policies.** Maintaining a strong reserves buffer will continue to support macroeconomic stability. Financial sector reforms should be aimed at increasing private sector credit growth, as well as continued improvements in financial development and inclusion. Strengthening the Anti-Money Laundering and Combatting the Financing of Terrorism (AML/CFT) framework would help safeguard financial stability.
- **Structural reforms.** Generating new sources of inclusive growth requires effective investment in human capital and infrastructure, structural reforms, and efforts to improve the business environment. Accelerating digital and green growth can foster longer-term economic transformation and improve resilience. Strengthening enforcement of governance standards, improving transparency (including for pandemic-related spending), and advancing the anti-corruption agenda remain crucial.

Approved By
Krishna Srinivasan and
Bjoern Rother

Discussions took place remotely during October 18–November 5, 2021. The staff team comprised J. Turunen (head), M. Deo, G. Cugat, Y. Zhou (all APD), M. Nose (FAD) and L. Hunter (Resident Representative, Pacific Islands). J. Pampolina (LEG) and L. Johnson (OED) joined some mission meetings. The mission met with central bank governor L. Forau, Permanent Secretary of the Ministry of Finance and Treasury M. Dentana and other government officials, representatives from the private sector, civil society organizations and development partners. E. Das and C. Kinsella provided research and editorial assistance.

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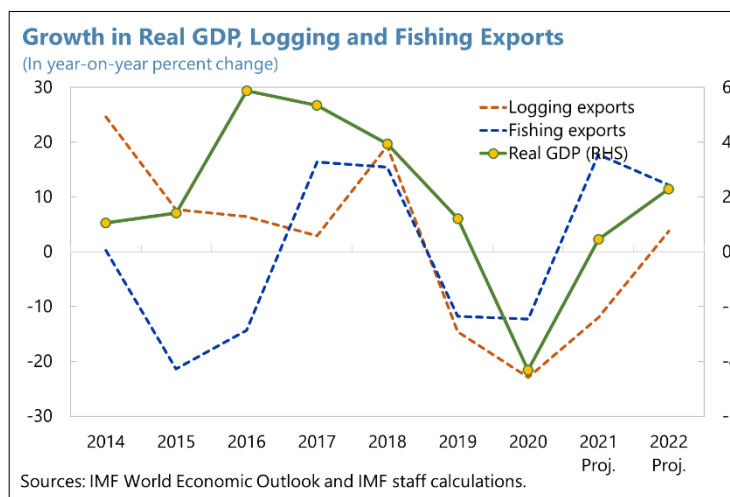
CONTEXT

1. Solomon Islands is a small, low-income, and geographically dispersed Pacific Island economy and a fragile state. The country has made significant strides over the past decades but continues to face development challenges, including from long-standing socio-economic tensions, vulnerability to natural disasters and climate change, infrastructure gaps and governance and corruption vulnerabilities. Economic activity slowed and fiscal position worsened before the COVID-19 pandemic owing to weakening logging exports and a pause in economic activity around the general election period. Logging has been a major contributor to growth, exports, and fiscal revenues, but resources are being depleted and production is expected to decline over the medium-term. Political protests reflecting lack of inclusive growth and uneven development across regions turned violent in late November 2021, resulting in three days of widespread unrest in the capital, Honiara.

2. Authorities have enacted strong and timely measures to contain COVID-19, with no record of local transmission thus far. Measures implemented by the government include temporary suspension of all commercial international flights and ban on entry of non-citizens, and strict mandatory quarantine for all returning passengers. Only around 14 percent of the eligible population has been fully vaccinated (as of November 5, 2021), owing in large part to widespread vaccine hesitancy. Progress in advancing vaccinations should be accelerated to meet the authorities target of 90 percent of the eligible population to allow timely and safe border reopening in the course of 2022.

RECENT DEVELOPMENTS: HEADWINDS FROM THE PANDEMIC

3. Economic activity has been hit hard by the impact of the COVID-19 pandemic. Real GDP is estimated to have contracted 4.3 percent in 2020, reflecting a fall in logging and fisheries exports owing to lower global demand as well as the impact of containment measures on trade and activity related to tourism, infrastructure projects and domestic demand. Labor market conditions deteriorated, as reflected in declines in the number of formal workers contributing to the National Provident Fund (NPF), with survey evidence indicating reduced incomes, decreased working hours and lower business revenues due to the partial



closure of markets.¹ The pandemic impact is likely to have limited access to economic opportunities, disrupted progress in poverty reduction and human development, thus contributing to the unrest in late November 2021. Inflation turned negative at the end of 2020 and remains low (at 1.4 percent in August 2021).

4. International reserves buffer was maintained due to donor inflows and lower imports.

Despite lower commodities exports, lower imports and strong income transfers resulted in a decline of the current account (CA) deficit to 1.6 percent of GDP in 2020. Donor inflows and official disbursements, including assistance from the Rapid Credit Facility/Rapid Financing Instrument (RCF/RFI) emergency financing, contributed to the build-up of foreign reserves.² The SDR allocation of SDR19.94 million (about US\$25 million, 1.5 percent of GDP) further supports foreign exchange reserves. At end-October 2021, foreign reserves stood at US\$717 million (about 11.6 months of prospective imports), with reserves coverage helping to preserve macroeconomic stability amid elevated uncertainty.

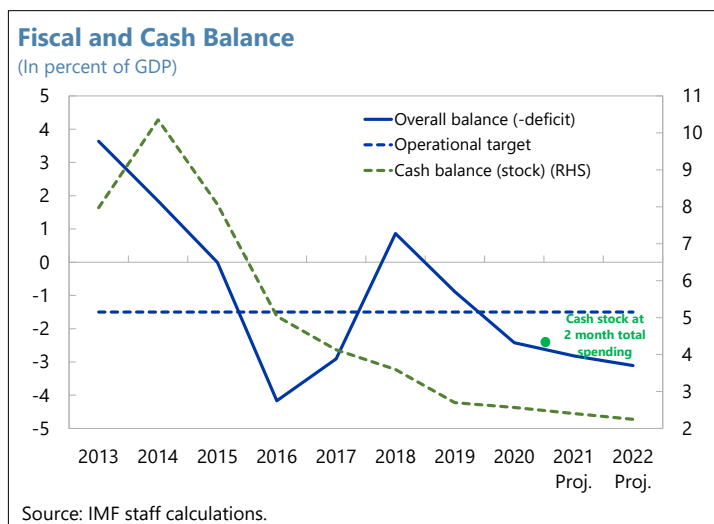
5. The government took swift fiscal policy measures, directing resources to essential services and the COVID-19 response.

The fiscal position deteriorated, reflecting lower revenues and additional COVID-19 related

spending. The authorities spent about SI\$137 million (1.1 percent of GDP) on COVID-19 prevention and containment measures and a fiscal stimulus package of SI\$319 million (2.6 percent of GDP) aimed at protecting jobs and incomes and stabilizing the domestic economy. Implementation of the fiscal stimulus package was spread over two years and completed in July 2021.

Additional donor support and domestic borrowing helped finance the 2020 fiscal deficit at 2.4 percent of

GDP. However, payment arrears reportedly re-emerged, reflecting structural Public Financial Management (PFM) weaknesses and increased liquidity pressures, and the cash balance remained well below the staff recommended minimum of two months of spending.



¹ ILO Rapid Assessment.

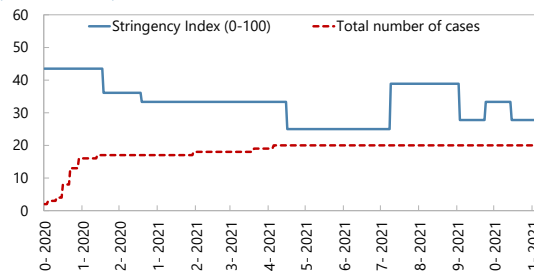
² Solomon Islands: Request for Purchase under the Rapid Financing Instrument and Disbursement under the Rapid Credit Facility-Press Release; Staff Report; and Statement by the Executive Director for the Solomon Islands (imf.org).

Figure 1. Solomon Islands: COVID-19 Status and Challenges Ahead

Solomon Islands has been able to prevent domestic transmission of COVID-19 so far...

COVID-19 Cases and Stringency Index

(Number of cases)



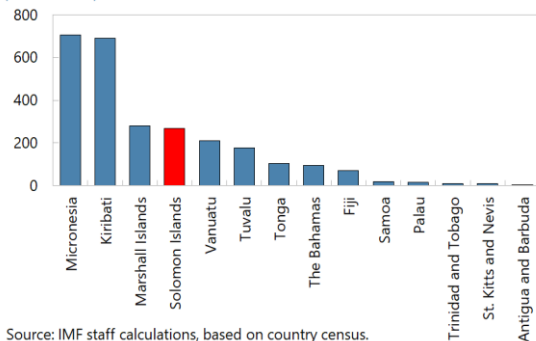
Sources: OWID and IMF Staff calculations.

Note: Stringency Index as composite measure based on 9 response indicators rescales to a value from 0 to 100 (100 strictest response) as of 8 November, 2021.

...with many challenges ahead, including high geographical dispersion.

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

(In kilometers)



Source: IMF staff calculations, based on country census.

... with significant gaps in terms of human development, particularly in education...

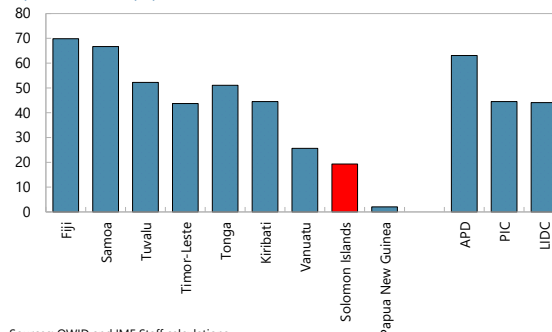
Country	Human Development Index	Life Expectancy (Years)	Expected Years of Schooling	Mean Years of Schooling	Gross National Income (GNI) per
Palau	0.83	73.9	15.8	12.5	19,317
Fiji	0.74	67.4	14.4	10.9	13,009
Tonga	0.73	70.9	14.4	11.2	6,365
Samoa	0.72	73.3	12.7	10.8	6,309
Marshall Islands	0.70	74.1	12.4	10.9	5,039
Kiribati	0.63	68.4	11.8	8.0	4,260
Micronesia	0.62	67.9	11.5	7.8	3,983
Vanuatu	0.61	70.5	11.7	7.1	3,105
Timor-Leste	0.61	69.5	12.6	4.8	4,440
Solomon Islands	0.57	73.0	10.2	5.7	2,253
Papua New Guinea	0.56	64.5	10.2	4.7	4,301

Source: United Nations Development Program and IMF staff calculations /1 2017 PPP U.S. dollars.

...but the vaccination rollout is lagging compared to peers...

Total Number of People Vaccinated - PIC

(In percent of total population)



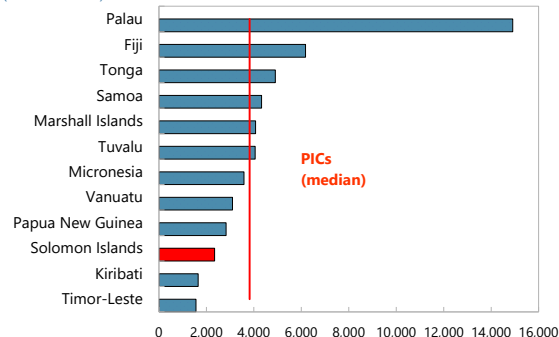
Sources: OWID and IMF Staff calculations.

Note: Total number of people who received at least one vaccine dose. APD (Asia-Pacific), PIC (Pacific and Small States) and LDC (Low Income Developing Economies) as median values as of 8 November, 2021.

The country remains one of the poorest in the region...

GDP per Capita, 2019

(In U.S. dollars)

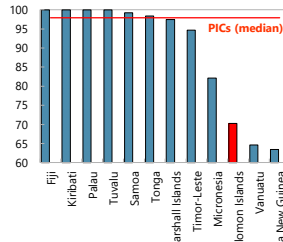


Sources: World Development Indicators and IMF staff calculations.

....and access to services such as electricity and internet, limiting the potential gains in the digital era.

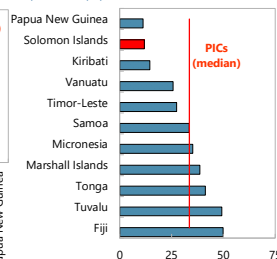
Access to Electricity

(In percent of population)



Individuals Using the Internet

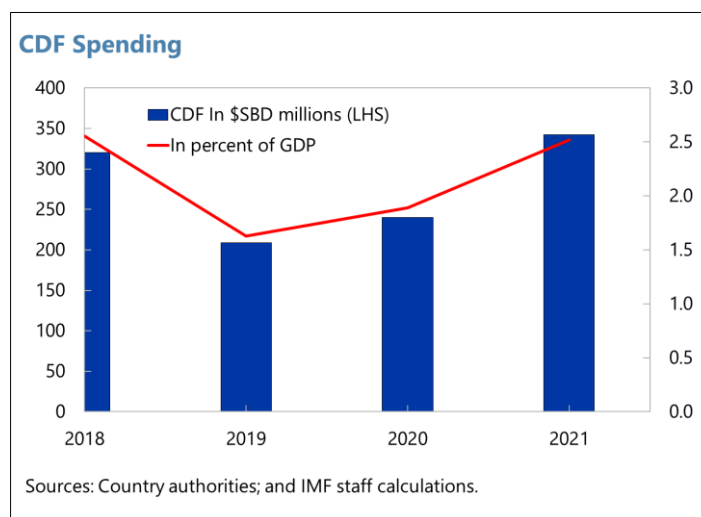
(In percent of population)



Sources: World Development Indicators and IMF staff calculations.

Solomon Islands: COVID-Related Fiscal Measures (percent of GDP, unless otherwise indicated)				
	2020		Change	2021
	Pre-COVID Proj.	Actual		Current Proj.
Priority expenditures 1/				
Health	4.3	5.2	0.9	4.7
Education	11.8	12.8	1.0	10.7
Social	2.2	2.4	0.2	3.0
Other Covid-related spending				
COVID prevention and containment 2/		1.1		0.7
Economic Stimulus Package 2/		1.7		1.5
<i>Memorandum:</i>				
Priority expenditures (percent of public spending)	44.6	49.9	5.3	48.5
Other Covid-related spending (percent of public spending)		12.2		2.2
Sources: Country authorities and IMF staff estimates.				
1/ IMF staff estimates that social spending includes spending on Women, Youth, and Children, Rural Development, and Land, Housing and Survey.				
2/ 2021 projections include estimates based on the Supplementary Budget Appropriations.				

6. The 2021 budget prioritized spending towards the COVID-19 response and economic recovery.³ The budget focused on preventing the spread of COVID-19 and improving service delivery; redirecting resources to support the economic recovery; and prioritizing investments in productive and resource sectors. Allocations to Constituency Development Funds (CDFs) were increased by 43 percent (accounting for 36 percent of total development expenditure).⁴ Additional expenditure to support COVID-19 related operations, support some state-owned enterprises (SOEs), provide stimulus to the targeted sectors and to settle arrears, is financed by donor support and higher domestic borrowing.



7. Accommodative monetary conditions have supported the economy and financial sector. The Central Bank of Solomon Islands (CBSI) has adopted an expansionary monetary policy

³ The Budget was approved in April and the Supplementary Appropriation Bill in October 2021.

⁴ CDFs are allocated to parliament members for use in their electorates. Although spending is aimed at supporting rural development, greater transparency is needed to demonstrate that spending is in line with the National Development Strategy.

stance to mitigate the effects of the pandemic. CBSI provided additional liquidity by reducing the cash reserve requirement (from 7.5 to 5 percent) and its holdings of central bank (“Bokolo”) bills and bought government bonds in the secondary market. Private sector credit growth nevertheless declined to close to zero in 2020. The newly re-introduced Development Bank of Solomon Islands (DBSI) started providing loans in 2020 focused on rural and underserved customers. Aggregate financial soundness indicators show a resilient financial sector, reflecting in part policy measures including CBSI temporarily waiving the requirement for classification of loans and loan loss provisions. However, banks have not made extensive use of the loan classification exemption. Nevertheless, non-performing loans (NPLs) had been increasing before the pandemic, and their high level coupled with a decline in profitability contribute to emerging vulnerabilities. Anecdotal evidence suggests that delays in government payments are contributing to an increase in NPLs in some sectors. Overall, while the immediate impact of the pandemic on the financial sector appears limited, conditions could worsen with subdued economic activity.

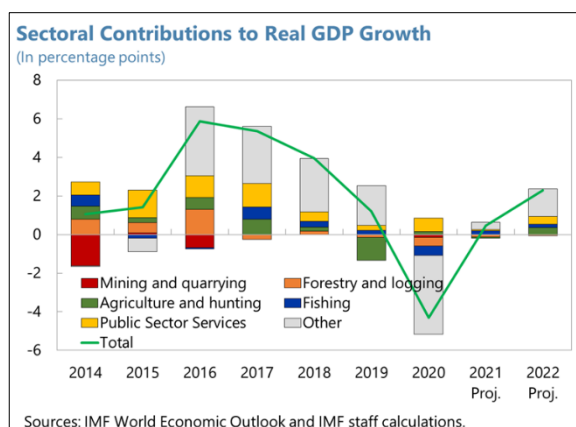
Core Financial Soundness Indicators, 2016-2021						
	2016	2017	2018	2019	2020	2021H1
(In percent, unless otherwise indicated)						
Capital Adequacy						
Regulatory Capital to Risk-Weighted Assets	32.5	35.0	31.1	31.3	33.7	33.4
Non-performing Loans Net of Provisions to Capital	6.6	12.2	11.8	18.0	16.6	18.1
Asset Quality						
Non-performing Loans to Total Gross Loans	3.8	6.4	7.1	10.4	10.6	11.4
Specific Loan Loss Provision to NPLs	31.2	18.7	30.9	29.4	29.9	28.7
Earnings and Profitability						
Return on Assets	3.5	3.9	3.5	3.1	2.1	2.5
Return on Equity	22.7	23.1	20.4	18.3	11.8	13.4
Interest Margin to Gross Income	56.3	55.0	54.6	53.6	59.1	59.6
Non-interest Expenses to Gross Income	43.7	45.0	45.4	46.4	40.9	40.4
Liquidity						
Liquid Assets to Total Assets (Liquid Asset Ratio)	38.1	38.4	40.4	37.4	45.4	46.5
Liquid Assets to Short Term Liabilities	53.3	55.4	56.0	56.3	64.7	62.9
Net open position in foreign exchange to capital	3.6	3.8	4.1	2.1	2.4	2.4

Source: Central Bank of Solomon Islands and IMF FSI.

OUTLOOK AND RISKS

8. Following a gradual recovery, growth is expected to increase driven by an infrastructure investment push. Real GDP growth is projected to have remained subdued at 0.4 percent in 2021 with increases expected in fishing, construction, and manufacturing. Unrest in late November 2021 increases downside risks to the near-term growth forecast. The relatively slow vaccine rollout and pandemic-related uncertainties are expected to delay full border reopening and international travel and therefore slow down the recovery in the near term. As borders reopen, construction is projected to become a key driver of growth as infrastructure projects are fast

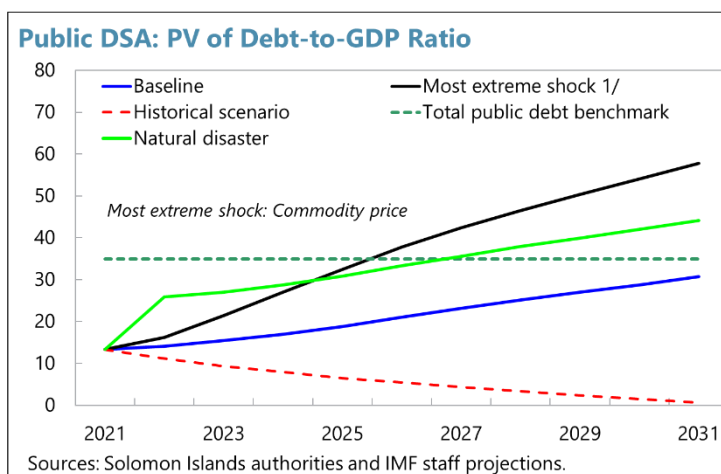
tracked, including for the 2023 Pacific Games and other priority projects. Investment in resource sectors such as mining and fishing are also expected to provide further impetus to growth. Growth is forecast to average just above 3 percent over the medium-term. Inflation is expected to increase, reflecting the impact of higher global commodity prices and pick-up in domestic demand, and average about 3.5 percent over the medium-term.



9. The CA deficit is projected to widen and reserves cover to decline. The more favorable CA balance observed in 2020 will likely be temporary. Imports are expected to recover at a faster pace than exports during 2021, leading to a CA deficit of about 5 percent of GDP. The deficit is expected to widen over time as logging exports decline and project-related imports increase. Financing from donors and new external debt is expected to fall short of the CA deficit, leading to a decrease in reserve cover over the medium term. Reserves are nevertheless expected to remain within the reserve adequacy range (estimated at 3-7.5 months of prospective imports).

10. The fiscal deficit and debt are projected to increase over the medium-term. The fiscal deficit is projected to widen to 2.9 percent of GDP in 2021 due to weak revenue performance.

However, late passage of the budget and constrained implementation capacity may require some planned development spending to be carried over to 2022 and fiscal pressures remain elevated. The deficit is projected to increase further over the medium-term, driven by continued weak revenue trends, including from lower revenue from logging and other international trade taxes, lower donor grants, and higher spending on public investment projects.⁵



Public debt is currently low. However, projected fiscal deficits are expected to drive the public debt-to-GDP ratio upward, reaching the authorities' nominal debt threshold of 35 percent of GDP by 2029. Concessional external loans should remain the main financing source, while the authorities aim to increase the issuance of domestic development bonds in line with their Medium-term Debt Management Strategy. The Debt Sustainability Analysis (DSA) indicates moderate risk of debt distress for both external and public debt, with substantial space to absorb shocks. However, stress

⁵ International trade taxes account for around one third of total revenues. The expected decline reflects implementation of the PACER Plus agreement between Australia, New Zealand, and Pacific Island countries.

tests, including a tailored natural disaster shock, result in breaches of the indicative DSA thresholds, highlighting the importance of rebuilding fiscal buffers against external shocks.

11. Risks to the outlook are tilted to the downside. Any domestic virus transmission could lead to a significant increase in human, as well as additional economic costs. New variants are an added risk factor, while vaccination delays could postpone a return to normal activity further. Fiscal risks have increased. Persistent government payment arrears could slow down private sector activity further and the decline in the cash balance limits ability to respond to shocks, heightening risks stemming from social spending gaps, natural disasters, and other external shocks. Financing options are constrained with the low cash buffer, relatively shallow domestic financing sources and lack of international market access, thus increasing dependence on development partner support. Additional downside risks include persistent social unrest and political instability, negative impact of climate change, and volatile commodity prices. On the upside, a stronger than expected global recovery owing to a faster than expected containment of the virus, a quicker rebound in tourism driven by regional reopening and acceleration in infrastructure investment could spur a stronger recovery.

Authorities' views

12. Authorities broadly agreed with staff's assessment of the outlook and balance of risks. The recovery depends critically on vaccination progress and border reopening. Authorities expect donor-supported infrastructure projects, logging, and fishing activities to support growth in the near-term, while the contribution of mining would increase over the medium term. While noting that investment in reforestation and higher domestic value-added in forestry can help bridge some of the gap created by the expected decline in logging activity, authorities recognized the need to generate new sources of growth. They noted that fiscal revenues were hit hard by the economic slowdown and emphasized their efforts to reduce financing gaps including through streamlining recurrent expenditures. Authorities explained that payment arrears from end-2020 were cleared and, while there had been further delays in payments, the government expected to clear all outstanding payments before the end of 2021.

ECONOMIC POLICIES

A. Fiscal Policy to Support the Economy

13. Targeted and transparent fiscal support is needed in the near-term. Given projected low growth and pandemic-related uncertainties, near-term fiscal support for the recovery continues to be appropriate, while accelerating growth enhancing structural reforms remains a priority. While continuing to prioritize support to productive and resources sectors to accelerate the economic recovery is welcome, it is also crucial to identify additional financing to provide targeted and transparent support to vulnerable households and businesses. Some economic support should be allocated and effectively targeted to hard-hit groups such as small and medium-sized enterprises (SMEs), the agriculture sector, and sectors that support employment. Shifting the composition of

spending away from inefficient and non-transparent spending, including on CDFs, while improving efficiency of health and education spending can create fiscal space for more targeted support. Authorities should avoid delays in government payments to help reboot private sector activity and prevent further negative spillovers to the financial sector.

14. COVID-19 related spending should be subject to effective governance safeguards to enhance spending efficiency and transparency. An Oversight Committee has been established to oversee COVID-19 spending and guard against any abuse or misuse of the package, including through an ongoing monitoring and evaluation process. The authorities have published information on stimulus recipients on their website and are in the process of conducting an impact evaluation. However, more should be done to ensure efficient and transparent spending. The authorities should promptly publish information on crisis-related procurement, including the names of the entities awarded the contracts and their beneficial owners. An audit of COVID-19 related expenditures is being prioritized and should be completed in 2022.

Authorities' views

15. Authorities highlighted their near-term twin objectives of protecting the country from COVID-19 and accelerating the economic recovery. The 2022 budget will focus on resilience and sustainable recovery by prioritizing investment in the productive and resource sectors while safeguarding essential services. Authorities noted that fiscal stimulus, such as support to SMEs and agriculture, will be included in development spending rather than a separate economic stimulus package. While further progress in governance reforms has been delayed owing to capacity constraints, authorities are in the process of conducting an impact evaluation of the COVID-19 economic stimulus package. The newly appointed Auditor General has made progress in audits related to COVID-19 spending (including procurement) for key institutions (including National Disaster Management Office and the Ministry of Infrastructure) and plans for audit of the economic stimulus package.

B. Restoring Fiscal Buffers and Ensuring Medium-Term Fiscal Sustainability

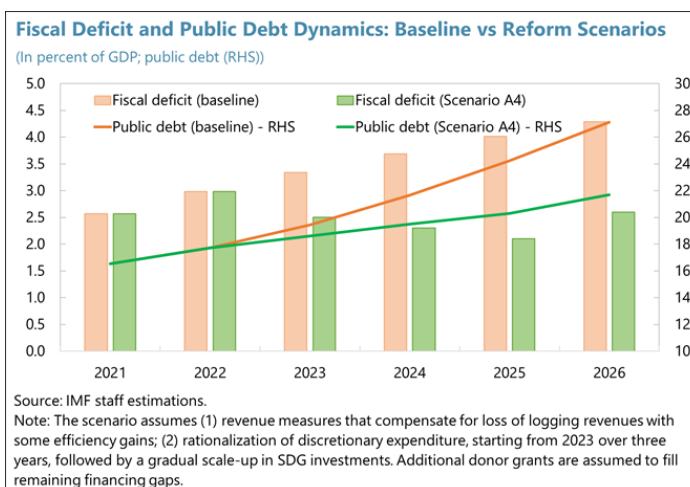
16. Post-pandemic policy should focus on rebuilding fiscal buffers. A gradual fiscal adjustment should start once the economic recovery is firmly underway and aim at gradually rebuilding fiscal buffers towards a broad cash balance of at least two months of total spending.⁶ Once the cash balance is restored, fiscal measures should be geared towards creating space for policy to support inclusive growth and development. An effective debt-based fiscal anchor can help guide policy (Box 1: Fiscal Anchor). Staff's illustrative reform scenario shows that a mix of additional donor support and fiscal measures focused on strengthening revenue administration and improving

⁶ There is no one-size-fits-all methodology to determine the optimal size of the cash buffer. The target depends on: (i) liquidity risk exposure; (ii) availability of risk mitigation tools; and (iii) opportunity costs (IMF, 2020). In practice, the target usually reflects the degree of liquidity risk. For Solomon Islands, in view of the significant liquidity risks relates to the volatility of logging revenues, donor funding, and unexpected fiscal spending due to natural disasters, holding a relatively large cash buffer remains prudent.

quality of spending and restraining expenditures on CDFs, could create space for spending on Sustainable Development Goals (SDGs) and climate adaptation.

- **Revenue administration measures.**

Recent efforts have yielded positive results. Additional efforts to improve compliance, tackle tax arrears, control exemptions (which amounted to 4.6 percent of GDP in 2020) and strengthen revenue administration could help raise significant revenue. The Tax Administration Bill, which aims to consolidate procedures and modernize tax administration, should be passed soon, and implementation should proceed accordingly.



- **Expenditure measures.** Resources should be channeled to growth enhancing spending, including spending towards achieving SDGs. There is room to improve the quality of spending through scaling back non-essential recurrent spending, restraining CDFs, and ensuring better budget planning, including for the Pacific Games. The authorities could build on the findings of the World Bank's upcoming public expenditure review to identify and pursue efficiency gains in public spending.
- **Tax policy measures.** Prompt VAT introduction and effective implementation can yield additional revenues over the medium-term. VAT reforms should consider rates to offset the projected decline in other revenues, aim at a broad base and ensure timely VAT refunds.

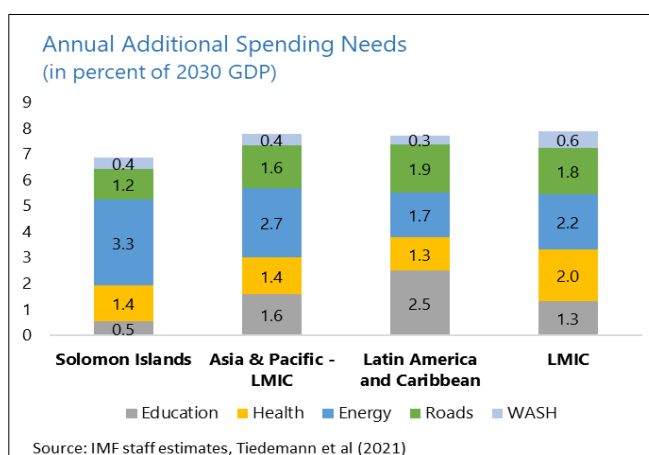
Solomon Islands - Tax Reforms		
Reform Area	Key Elements	Progress
Tax Administration Bill	<ul style="list-style-type: none"> Consolidates tax administration procedures which is currently scattered throughout the various tax legislations. Modernizes and unifies the administration of all tax types. It also provides a framework for self-assessment and electronic payment and lodgment. 	<ul style="list-style-type: none"> Cabinet has approved.
VAT Act	<ul style="list-style-type: none"> The VAT is intended to replace a range of existing taxes (goods taxes, sales taxes, custom duty on most imports, stamp duty, Proposed rate: 15 percent. Proposed threshold: SI\$ 600,000. Base recommended to be broad with few concessions. 	<ul style="list-style-type: none"> Draft bill is awaiting Cabinet decision regarding rates and threshold.
Income Tax Act	<ul style="list-style-type: none"> Authorities recognize that the Act needs to be reviewed and simplified. 	<ul style="list-style-type: none"> This will be the next priority item following VAT implementation.
Sources: ADB and IMF staff.		

17. Further fiscal reforms are needed to support fiscal sustainability over the medium term. Setting a comprehensive Medium-term Revenue Strategy (MTRS) would guide policy goals, identify a realistic spending envelope, and help sequence reforms. Fundamental tax reform is an opportunity to broaden the tax base, mitigate the decline in logging revenues and trade tariffs, identify new sources of revenue, strengthen mining taxation (including by reviewing the Mining Bill) and generate revenue more efficiently, fairly, and equitably. Following the introduction of the Tax Administration Bill and the VAT Act, included in the first stage of the government's Tax Reform Review, other reforms focused on income taxes and other taxes, rents and excises should proceed as planned. Ensuring adequate funding and implementation capacity in Inland Revenue and Customs, and cementing progress already made on revenue administration would help underpin the fiscal position. Upgrading IT systems would help ease the burden of taxpayer compliance and reduce administrative costs.

18. Achieving SDGs while making progress in climate adaptation will require investment in health, education, and key infrastructure. It is estimated that Solomon Islands would need additional

spending of about 6.9 percent of 2030 GDP per year to meet SDG targets on health, education, and infrastructure while building climate resilience (Selected Issues Paper: Spending needs for Achieving SDGs with Climate Resilience). Scaling up renewable

energy investment and improving energy efficiency should be prioritized to increase access and lower the cost of electricity, as well as to make progress in climate adaptation. Improving the efficiency of education and health spending can yield large welfare gains and promote inclusive growth.



Box 1. Fiscal Anchor¹

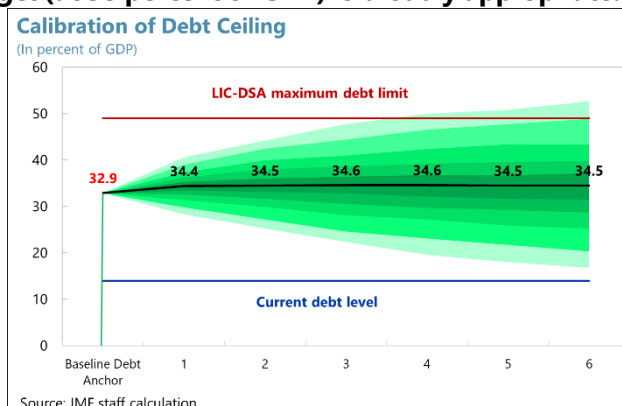
An effective debt-based fiscal anchor can help guide policy. The last five years have seen persistent primary deficits and rising debt, with public debt amounting to 13.4 percent of GDP in 2020. Going forward, government borrowing is likely to increase to meet mounting development spending needs and to cope with the impact of climate change and natural disasters while logging, the main source of revenue, continues to decline.² As government faces a trade-off between its long-term development spending needs and fiscal risks, it is, therefore, important to assess whether the current debt target is reasonable.

Box 1. Fiscal Anchor (concluded)

Simulations suggest that the current debt target (at 35 percent of GDP) is broadly appropriate.³

The appropriate level of the debt ceiling is defined as the maximum prudent level of government debt that is calibrated to have sufficient buffer to withstand unexpected shocks to the economy. Risks to public debt are calculated via a stochastic approach and incorporates three sources of risk: fiscal policy shocks, reflecting expenditure slippages or revenue shortfalls; budget's sensitivity to macroeconomic and financial developments; and direct impact of macroeconomic shocks on debt dynamics.⁴ The model estimates the

maximum level of public debt that would keep debt, given estimated dynamics, below the high-risk debt distress threshold in the LIC-DSA if tail-risk shocks materialize.⁵ Based on this methodology the debt ceiling is calibrated at 32.9 percent of GDP, suggesting that the current debt level is well below the ceiling with sufficient safety margin to withstand unexpected shocks. The government's current debt target is close to the calibrated ceiling and therefore still offers a reasonable anchor. At the same time there is limited space to further raise the target.



Operationalizing the fiscal anchor will require an appropriate operational target and strengthening PFM. With current debt level still well below 35 percent of GDP, the limit does not provide an adequate anchor for policy. A well-designed operational deficit target could balance containing debt levels with addressing spending needs. Medium Term Fiscal Strategy (including financing) should be published annually to support effective operation of the fiscal anchor and operational target. Given vulnerability to natural disasters, the fiscal anchor could include an “escape clause” that allows for the temporary breach to accommodate emergency spending in response to shocks.

¹ Prepared by Manabu Nose and Yong Sarah Zhou.

² Debt targets have been raised twice starting from 25 percent in 2017.

³ Calibration relies exclusively on the need to protect the fiscal position against negative shocks. However, in Solomon Islands, as in many other countries, increasing public investment and funding SDGs are also priorities and at least part of these expenditures must be financed through public debt.

⁴ IMF (2018) “How to Calibrate Fiscal Rules: A Primer”, How to Notes.

⁵ Reference threshold of 57 percent (consistent with the present-value of public debt-to-GDP ratio 35 percent for LICs with weak debt-carrying capacity) minus 8 percent to account for fiscal risk related to natural disasters (see Lee, Zhang, and Nguyen (2018) “The Economic Impact of Natural Disasters in Pacific Island Countries: Adaptation and Preparedness” IMF WP/18/108).

20. Strengthening fiscal governance and greater transparency remain essential. Fiscal governance reforms should continue. Immediate priorities include finalizing the regulations under the PFM Act, improving liquidity forecasting, cash management, and expenditure control to prevent accumulation of payment arrears. Ensuring that budget allocations are aligned with development priorities, implementing expenditure controls, and developing a medium-term expenditure framework can promote fiscal sustainability. Investment decisions, borrowing and procurement for infrastructure projects, including the Pacific Games, should be transparent, aligned with the development agenda, follow robust project appraisal and selection, consider maintenance costs, and

be on grant or highly concessional terms. Strengthening regulatory and enforcement of the fiscal regime on mining would help reap benefits from increased activity. Use of CDFs should be transparent with regular monitoring and reporting. As also noted in the 2019 Article IV Staff Report, the review of the CDF Act and supporting regulations should be completed. Capacity issues at the constituency level also need to be addressed. To demonstrate that CDF spending is in line with the National Development Strategy, the budget should report on the extent to which CDF spending is promoting the main social development areas.

Authorities' views

21. Authorities shared staff's views on rising fiscal challenges and the need for revenue mobilization, while highlighting progress in advancing key legislation. They agreed that declining logging revenue and large development spending needs will increase fiscal pressures. Authorities highlighted recent reform efforts to improve medium-term revenue mobilization, noting that the Tax Administration Bill has been sent to the Parliament for approval. Other important reforms include the National Payment System and the recently completed PFM Procurement Regulation. They also acknowledged their commitment to their Medium-term Debt Strategy and expect to begin rebuilding fiscal buffers, including by leveraging resources mobilized through domestic development bond issuance. Authorities recognized the importance of reviewing the CDF Act and regulations to improve spending efficiency and transparency.

C. Monetary and Exchange Rate Policy to Support Macroeconomic Stability

22. Accommodative monetary policy continues to support the economy. The monetary policy stance is appropriate for current conditions of subdued economic activity, low private sector credit growth and limited inflationary pressures, although the transmission channels are weak. Any additional CBSI purchase of government bonds should continue to be undertaken in a transparent manner and be limited in time and scale. CBSI should carefully plan and clearly communicate a cohesive exit strategy from quantitative easing to limit risks to monetary policy credibility and central banks' operational independence. The authorities have committed to undergo an updated safeguards assessment as part of the RCF/RFI emergency financing.

23. The current exchange rate regime based on a basket of currencies remains appropriate. The additional injection of foreign reserves during the pandemic has supported the exchange rate regime. The CBSI relaxed some exchange control measures on payment limits (for trade, all services, and personal remittances). As of end-October 2021, the currency basket that anchors the exchange rate regime has depreciated by 1.9 percent, mostly due to nominal depreciation against the US dollar. Exchange rate management could be improved by annual revisions of the basket and the choice of the intervention currency and increasing transparency by publishing the composition of the basket. Managing the exchange rate in line with updated basket weights, together with structural reforms, would support competitiveness.

24. Staff assess the external sector position to be moderately weaker than suggested by medium-term fundamentals and desirable policies. In 2020 the CA deficit was weaker than the norm by about 1 percentage point, equivalent to an overvaluation of the real effective exchange rate of about 4 percent. Reserve coverage was adequate at 13.5 months of prospective imports, well above the adequacy range estimated at 3-7.5 months of prospective imports. However, the CA deficit is expected to widen and reserves coverage to decline. The Solomon Islands is a resource-rich, fragile, and small economy, and maintaining sufficient reserves buffers is warranted given the pandemic related uncertainties, frequent natural disasters, and the need to preserve the credibility of the exchange rate regime.

Authorities' views

25. Authorities expect to maintain an accommodative monetary policy stance and viewed the basket exchange rate regime as working well. CBSI does not expect further government bond purchases in 2021 and any purchases looking forward would depend on the strength of the recovery. Authorities noted that the review of the exchange rate basket, postponed due to the pandemic, would consider updating the currency weights; and would also look at the management of exchange rate operations. Authorities would like to promote the accumulation of foreign exchange reserves through an increase in exports and confirmed their intention to hold the new SDR allocations as reserves.

D. Safeguarding Financial Stability while Promoting Financial Development

26. The financial sector has remained stable but potential vulnerabilities should be addressed proactively. NPLs were elevated before the pandemic and anecdotal evidence suggests additional pressure in some sectors, calling for close monitoring and supervision. As of end-October, after a temporary halt, the CBSI has re-established its prudential guidelines in consultation with financial institutions and any future exemptions are expected to be targeted and based on a case-by-case analysis. Excess liquidity in the system has remained high, providing buffers. The NPF's earnings and capital deteriorated in 2020. NPF exposure to government debt remains low despite recent purchases of government bonds. Effective CBSI supervision of the DBSI and its management practices is needed to minimize government contingent liability risks.

27. Strengthening the AML/CFT legal framework would help mitigate pressures on CBR pressures and safeguard financial stability. CBRs have been under pressure throughout the region, highlighting the need to strengthen AML/CFT effectiveness (Box 2: Priorities for AML/CFT Reforms). Banks and the CBSI should continue to seek alternative solutions and establish contingency plans in case pressures re-emerge. Alignment of AML/CFT legal framework with the Financial Action Task Force (FATF) standards and improving risk-based supervisory capacities are needed to reduce financial integrity risks.

Box 2. Priorities for AML/CFT Reforms¹

The region is facing acute pressures on CBRs. As many other Pacific Island countries, CBRs for some banks operating in Solomon Islands have been under pressures over the past several years. Several factors have contributed to the pressure on CBRs, including weaknesses in AML/CFT supervision of banks and other financial institutions, high cost of conducting due diligence for transactions, and profitability concerns.

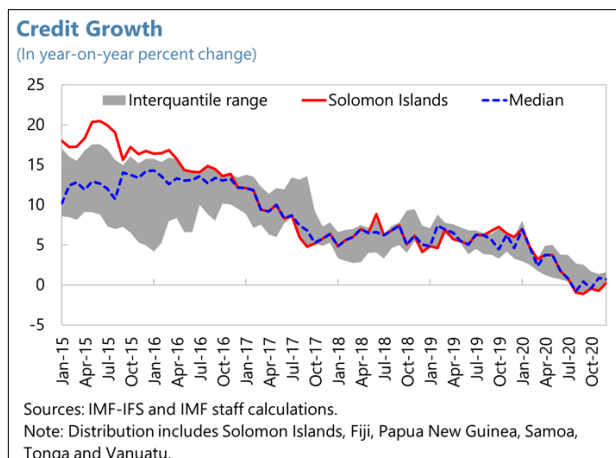
Deficiencies in the AML/CFT legal framework and supervision create financial integrity risks. The AML/CFT legal framework is not fully aligned with the FATF standards. The 2019 Mutual Evaluation Report (MER) by the Asia Pacific Group on Money Laundering highlighted key technical deficiencies including on the AML/CFT supervisory framework and implementation, as well as preventative measures implemented by reporting institutions.

Alignment of AML/CFT legal framework with the FATF standards should be prioritized. The CBSI has already taken welcome steps to address the findings of the 2019 MER such as increasing FIU staffing. The Anti-Money Laundering Council has endorsed the National Strategic Plan and a new AML/CFT legal framework is expected to be submitted to the Parliament in 2022. Clarifying AML/CFT supervisory responsibilities among the agencies is needed to maximize limited resources.

Risk-based supervisory capacities need to be improved. Once the supervisory roles are clarified, focus should turn to enhancing offsite monitoring and onsite inspections, with focus on high-risk sectors and institutions. With capacity development assistance from the Fund, AML/CFT supervisory tools should be developed to support a risk-based approach. These should cover monitoring tools (covering high risk customers), supervisory strategy, onsite inspection practices, and enforcement actions, as well as strengthening the institutional capacities and practices.

¹ Prepared by Jonathan Pampolina and Yong Sarah Zhou.

28. Stronger private sector credit growth is needed to support the post-pandemic recovery. Potential supply side policies to revitalize credit growth include reforms aimed at increasing competition in the financial sector, using new technologies to reduce asymmetric information and improving debt enforcement and resolution frameworks. Reforms to ease constraints to doing business, such as improving land and property registration, can help generate an enabling environment. On the demand side, promoting financial literacy and inclusion, expanding concessional loan facilities (for example, through the DBSI), well-targeted credit guarantee schemes and investment opportunities through public private partnerships can help spur credit growth.



29. Reforms to support financial sector development and inclusion should continue. Staff welcomes the progress on CBSI's prudential guidelines, the National Payment System, and the new

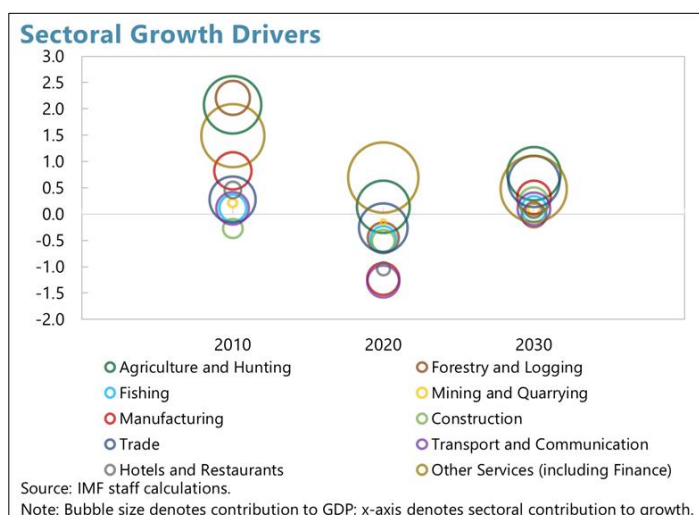
National Financial Inclusion Strategy. At the same time, updating financial sector legislation should be prioritized. The experience with the NPF's saving scheme for informal workers, youSave LoMobile, embodies the potential for advancing digital financial inclusion through public private partnerships. The government should continue to promote financial literacy and ensure that regulatory framework and legislation related to use of new technologies and digital services are in place and up to date.

Authorities' views

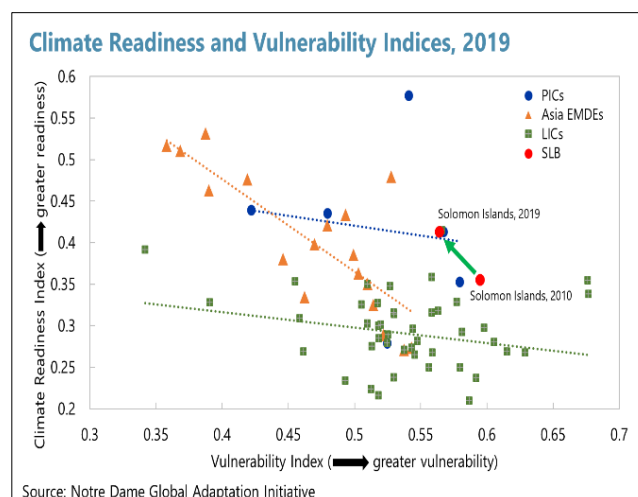
30. Authorities agreed with the need to promote private sector credit growth and financial development, and to strengthen the AML/CFT framework. The CBSI is close to completing its review and update of prudential guidelines. Authorities have recently created a taskforce to make the lending environment more conducive to increasing private sector credit. They highlighted the importance of DBSI financing and the new instruments targeted to SMEs, rural and exporting sectors. Authorities have introduced a National Strategic Plan, increased staffing and supervisory capacity at the Financial Intelligence Unit and conveyed strong interest in addressing AML/CFT challenges including through continued technical assistance. Authorities argued in favor of a regional approach to resolving CBR challenges and are actively participating in the development of a regional electronic know-your-customer utility.

E. Structural Reforms to Foster Diversification and Sustainable Growth

31. The decline in logging and impact of the pandemic have increased the urgency of diversifying the economy and finding new growth drivers. Infrastructure investment can lead to higher near-term growth and productivity gains, but projects should be carefully prioritized. Solomon Islands lags peers in access to basic services, such as electricity and sanitation, and investment in these sectors should be prioritized. Increasing local value-added in agriculture and improving connectivity within and across islands can increase production and reduce reliance on food imports, while at the same time supporting diversification. Fisheries and mining have potential, but require additional responsible investment in infrastructure and production facilities. The recent completion of the undersea cable has improved internet connectivity and provides opportunities for developing e-commerce, digital financial services and digitalization of government services. While tourism has significant potential, the post-pandemic recovery depends crucially on the reopening of international borders and the level of preparedness by authorities and tourism operators.



32. Building resilience to climate change and natural disasters is a key priority for sustainable growth. Authorities have made gradual progress in improving their climate readiness, especially in the energy sector. Although additional spending needs for climate adaptation are large, climate-proofing projects have benefited from concessional financing from donors and climate funds.⁷ Green financing (incorporating green indicators and targets in projects) supported by development partners could help attract private capital. Early climate investments are expected to mitigate the negative impact of natural disasters on growth, fiscal space, and debt sustainability.⁸ Prioritizing climate-proofing capital investments would boost welfare gains from climate adaptation.



33. Structural bottlenecks, including governance vulnerabilities, should continue to be addressed through reforms. Land issues remain a critical obstacle for doing business and improving registration procedures and dispute resolution mechanisms can help collateralize properties and facilitate investment. Electricity prices remain relatively high, and affordability concerns need to be addressed as generation capacity increases (including through completion of the Tina Hydro Project).⁹ SOE reforms, including to support commercial operations, have resulted in steady improvements and should continue. However, performance varies across SOEs and more timely financial reporting is needed. Consistent with the recommendations in the 2019 Article IV consultation, significant additional efforts are needed to address governance vulnerabilities and to strengthen the anti-corruption framework, including through further advancing towards effective and independent anti-corruption institutions as well as accessible asset disclosure system for high-level public officials.¹⁰

Authorities' views

34. Authorities agreed on the importance of a sustainable growth recovery and are determined to promote economic diversification and build resilience through structural reforms. They aim to advance the review of the mining legislation and accelerate reforms in the forestry sector to promote re-forestation and downstream processing. Authorities also highlighted

⁷ IMF (2021): "Unlocking Access to Climate Finance for Pacific Island Countries", Departmental Paper.

⁸ IMF (2018): Solomon Islands: Selected Issues – Public Investment in the Face of Natural Disasters: A Model Application to Solomon Islands.

⁹ High electricity costs reflect reliance on diesel-based electricity generation. The government recently announced a cut in electricity tariffs expected to reduce power bills by around 18 percent.

¹⁰ For more detailed analysis and policy recommendations, see the 2019 Article IV Staff Report.

the progress made in tax reforms, digitalization, and the National Payment System and the potential improvements in business environment and growth benefits they could bring. Authorities viewed the overall progress in achieving the SDGs and climate goals as mixed. They stressed significant progress in the energy sector, while noting that the COVID-19 pandemic and more frequent natural disasters have deepened development challenges. They noted the heavy reliance on donor financing and agreed that an integrated financing strategy would create fiscal space for achieving SDGs and climate goals going forward. Authorities also agreed on the importance of improving spending efficiency, mainly in the education and health sectors.

F. Other

35. Fund capacity development (CD) has supported COVID-19 responses and has been closely integrated with policy priorities. Recent CD has included support in several areas, including revenue administration; prudential standards and risk-based banking supervision; macroeconomic statistics and analysis; fiscal reporting under the PFM program; minerals pricing and associated revenue risks; central bank risk management; macroeconomic forecasting, modeling, and monetary policy frameworks and strengthening AML/CFT. CD support in many of these areas is expected to continue, with support focusing also on medium term revenue mobilization, governance/supreme audit institutions and data transparency.

36. Further progress in improving macroeconomic statistics should be given a higher priority. Technical assistance has focused on high frequency activity data, improving coverage and scope, and increasing staff capacity for compilation of Government Finance Statistics, balance of payments, and GDP (including rebasing) data.

Authorities' views

37. Authorities expressed their appreciation for continued Fund capacity development support and noted progress in macroeconomic statistics. The authorities welcomed planned CD support and called for technical assistance on data transparency through the Enhanced General Data Dissemination System (e-GDDS). The MTRS remains a priority for the government. Authorities expect to publish recent census results and rebased GDP estimates soon.

STAFF APPRAISAL

38. Strong and timely containment measures have successfully prevented a domestic COVID-19 outbreak. However, economic activity has been hit hard and pre-existing socio-economic tensions aggravated by the impact of the COVID-19 pandemic. Following an initial contraction, growth is projected to recover gradually and to gain strength as containment measures are relaxed and borders re-opened. Inflation is expected to increase, in part reflecting the impact of higher commodity prices. Fiscal pressures remain elevated, and the government has reprioritized spending towards essential services, while aiming to accelerate the recovery. Despite strong external buffers, weakening of the fiscal position increases vulnerability to shocks, while the decline in

logging weighs on fiscal revenues and growth over the medium-term. Risks to the economic outlook are skewed to the downside.

39. Policy measures are needed to ensure a durable recovery in the near-term. The government should identify additional financing to provide targeted and transparent support to vulnerable households and businesses and continue efforts to avoid any delays in government payments. COVID-19 related spending should be subject to effective governance safeguards to enhance spending efficiency and transparency. Expenditures in areas with weak transparency and governance practices, including CDFs, should be contained. Progress in reforms such as the Tax Administration Bill, National Payment System and introduction of procurement regulations is welcome, but timely and effective implementation is critical.

40. Post pandemic fiscal policy should focus on rebuilding buffers, maintaining sustainability and reforms to strengthen governance. Post-pandemic policies should focus on rebuilding fiscal buffers to enhance resilience and address spending needs for progress towards SDGs. An effective debt based fiscal anchor can guide fiscal policy. Modernizing tax administration and introducing a Value Added Tax are important first steps towards comprehensive tax reforms. Reforms are needed to improve fiscal governance, advance PFM, and establish a comprehensive medium-term revenue strategy to maintain fiscal sustainability.

41. Accommodative monetary policy and the current basket exchange rate regime remain appropriate. The monetary policy stance remains appropriate for current conditions of subdued economic activity and low private sector credit growth. Any additional CBSI purchase of government bonds should continue to be undertaken in a transparent manner and be limited in time and scale. The external sector position is assessed to be moderately weaker than suggested by medium-term fundamentals and desirable policies. Maintaining a strong reserves buffer will continue to support credibility of the exchange rate regime and macroeconomic stability.

42. Potential financial sector vulnerabilities should be addressed proactively. NPLs were elevated before the pandemic and anecdotal evidence suggests additional pressure in some sectors, calling for close monitoring and supervision. At the same time, stronger private sector credit growth is needed to support the post-pandemic economic recovery. Financial sector reforms should be aimed at increasing private sector credit growth, as well as continued improvements in financial development and inclusion. Strengthening the AML/CFT framework would help mitigate pressures on CBRs and safeguard financial stability.

43. Decline in logging and impact of the pandemic have increased the urgency of diversification and finding new growth drivers. Generating new sources of growth and economic opportunities requires effective investment in human capital and infrastructure, structural reforms, and efforts to improve the business environment. Building resilience to climate change and natural disasters is a key priority for sustainable growth, while accelerating digital and green growth can foster longer-term economic transformation and improve resilience. Strengthening enforcement of governance standards, improving transparency, and advancing the anti-corruption agenda remain crucial.

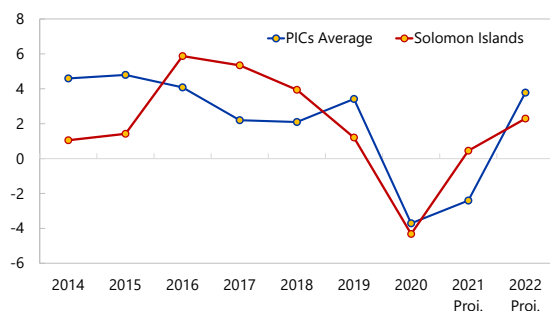
44. It is proposed that the next Article IV consultation takes place on the standard 12-month cycle.

Figure 2. Solomon Islands: Macroeconomic Developments and Outlook

A modest recovery is expected this year following a contraction in 2020...

Real GDP Growth Rate

(In year-on-year percent change)

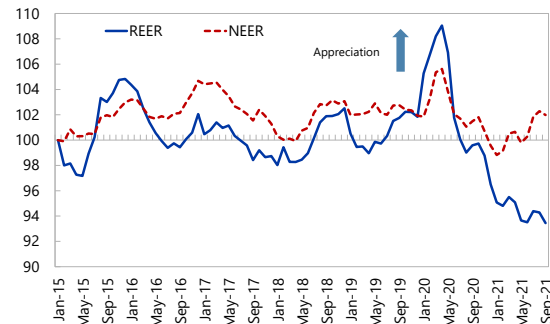


Sources: World Development Indicators and IMF staff calculations.

The real exchange rates have depreciated...

Nominal and Real Exchange Rates

(Jan-2015 = 100)

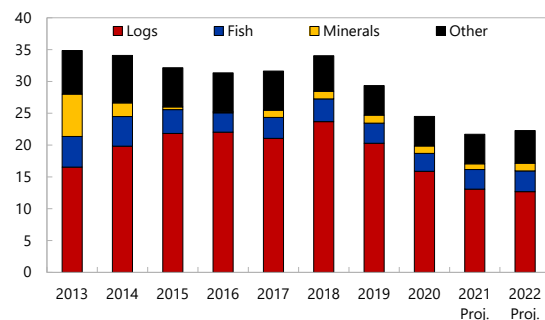


Sources: IMF-IFS and IMF staff calculations.

...as logging exports have peaked...

Total Exports

(In percent of GDP)

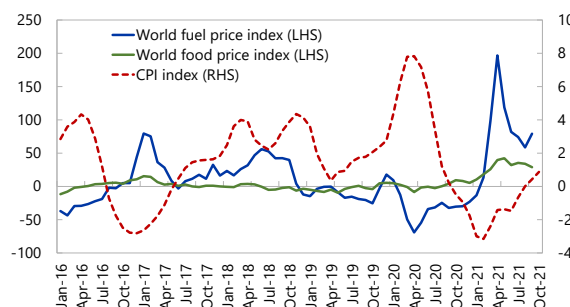


Sources: World Economic Outlook and IMF staff calculations.

Commodity prices have risen sharply,

CPI Inflation and World Food/Fuel Price Index

(In year-on-year percent change)



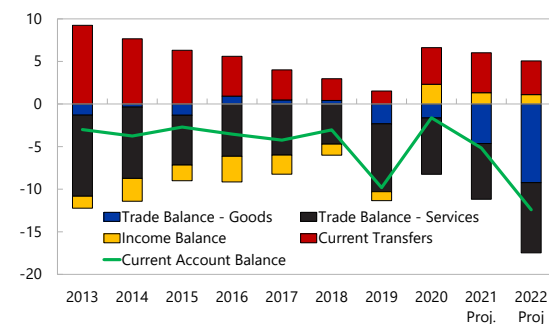
Source: IMF staff calculations.

Note: CPI year on year percent change, 3 months moving average.

...while the current account deficit narrowed during the pandemic, it is expected to widen...

Current Account Balance

(In percent of GDP)

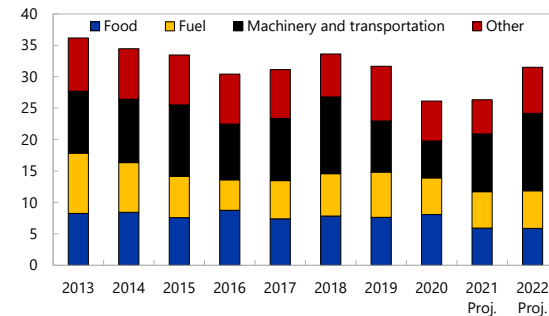


Sources: Solomon Islands authorities and IMF staff estimates.

...and imports are expected to increase, driven by infrastructure projects.

Total Imports

(In percent of GDP)



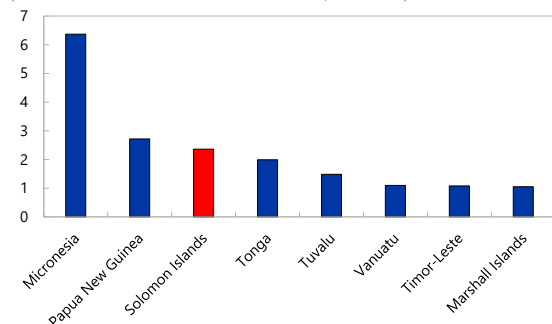
Sources: IMF World Economic Outlook and IMF staff calculations.

Figure 3. Solomon Islands: Fiscal Indicators

Solomon Islands tax revenue is highly volatile...

Volatility of Tax Revenue

(Standard deviation of tax revenue to GDP ratio, 2008-2021)

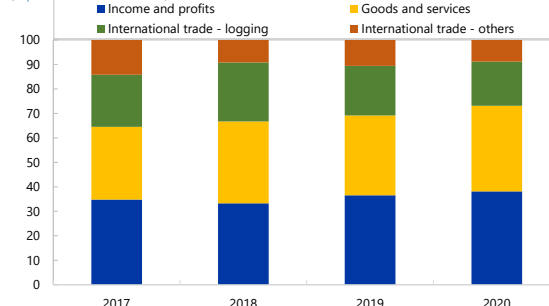


Sources: IMF World Economic Outlook and IMF staff calculations.

... and with high reliance on logging revenue.

Composition of Tax Revenue

(In percent of total tax revenue)

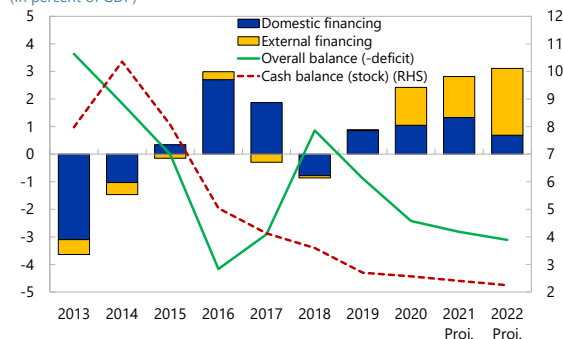


Sources: Solomon Islands authorities and IMF staff calculations.

The cash balance has declined significantly, and the fiscal deficit has widened...

Fiscal Balance and Financing

(In percent of GDP)

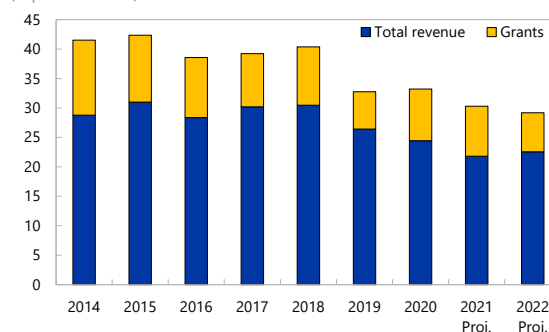


Source: IMF staff calculations.

...reflecting a negative impact of the COVID-19 pandemic on revenues.

Government Revenue

(In percent of GDP)

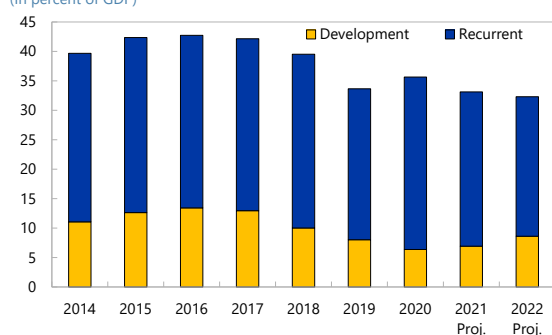


Sources: IMF World Economic Outlook; and IMF staff calculations.

Spending also declined but infrastructure projects are expected to drive total expenditure higher...

Government Expenditure

(In percent of GDP)

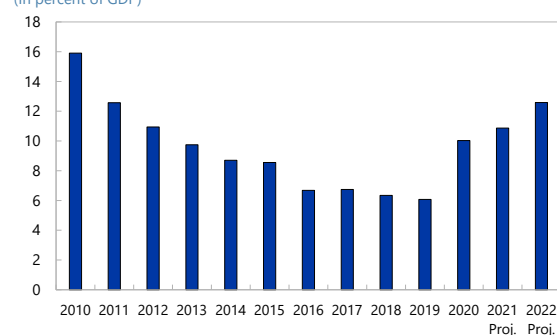


Sources: IMF World Economic Outlook; and IMF staff calculations.

...leading to a significant increase in public debt.

Public External Debt

(In percent of GDP)



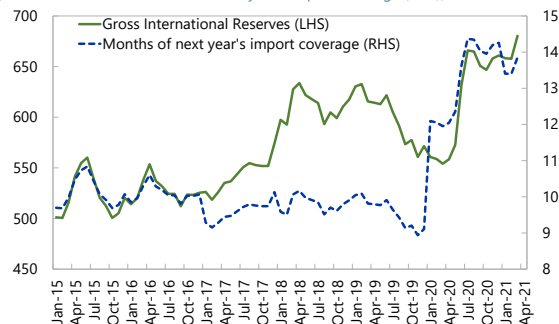
Sources: IMF World Economic Outlook and IMF staff calculations.

Figure 4. Solomon Islands: Money and Credit Developments

Foreign exchange reserves have improved thanks to external financing and cover remains comfortable...

Gross International Reserves

(In millions of USD; in months of next year's import coverage (RHS))

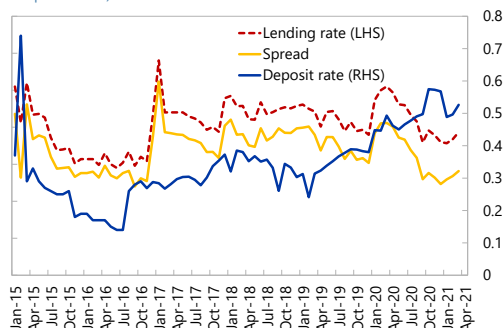


Sources: CBSI and IMF staff calculations.

Banking sector spreads are declining reflecting downward trending lending rate

Lending and Deposit Rates

(In percent per annum)



Sources: IMF-IFS and IMF staff calculations.

Broad money growth is relatively modest...

Broad Money

(Year-on-year percent change)

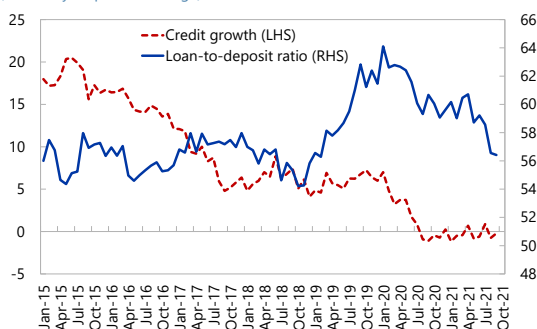


Sources: IMF-IFS and IMF staff calculations.

...and credit growth is weak as banks have pulled back lending.

Credit Growth

(Year-on-year percent change)

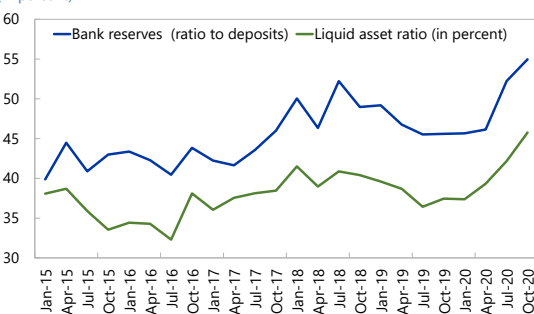


Sources: IMF-IFS and IMF staff calculations.

Bank excess reserves continue to increase...

Bank Reserves and Liquid Asset Ratio

(In percent)

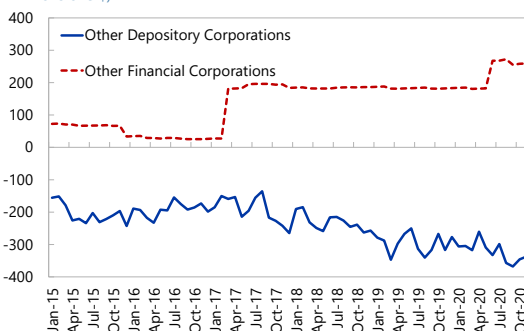


Sources: IMF-IFS and IMF staff calculations.

... and credit to central government ticked up after recent bond issuance.

Net Credit to Central Government

(In millions of S\$)



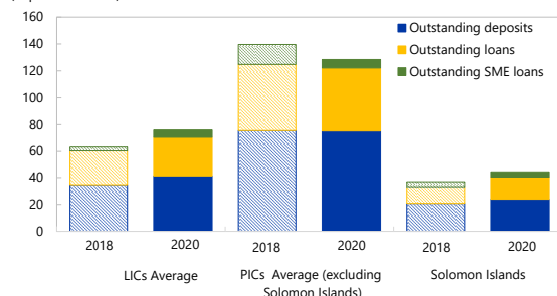
Sources: CBSI and IMF staff calculations.

Figure 5. Solomon Islands: Progress and Remaining Gaps Related to SDGs

Financial inclusion has been improving slowly...

Deposits, Loans and SME Loans

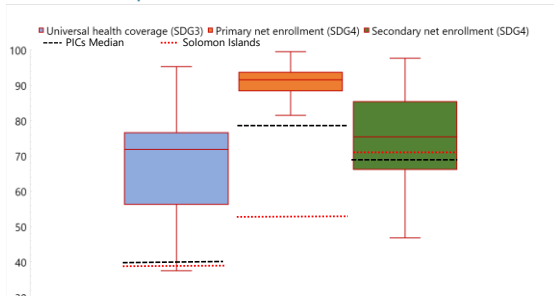
(In percent of GDP)



Source: Financial Access Survey, IMF.

The progress towards SDGs related to human capital is still lagging peers...

Sustainable Development Goals on Health and Education, 2020



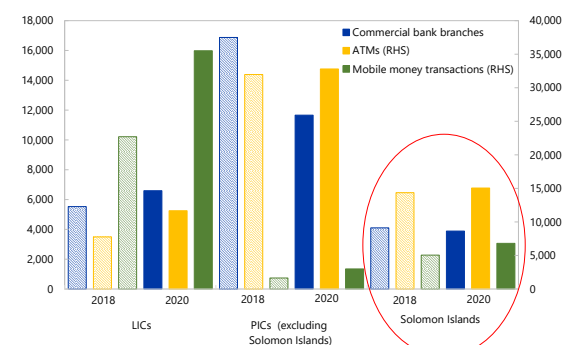
Source: United Nations Sustainable Development Report, 2020.

Note: Scores range from 0 (worst) to 100 (best performer) following Sachs et al (2020). Box plot displays the quartiles

...while access to traditional banking is limited, mobile transactions are higher than in other PICs.

Commercial Bank Branches and ATMs

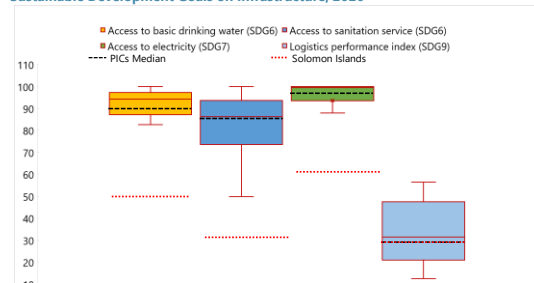
(Per 1,000 adults; per 1,000 mobile money transactions in given year)



Source: Financial Access Survey, IMF.

...as is the progress towards improving basic infrastructure.

Sustainable Development Goals on Infrastructure, 2020

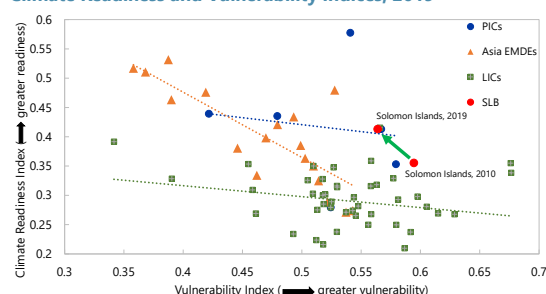


Source: United Nations Sustainable Development Report, 2020.

Note: Scores range from 0 (worst) to 100 (best performer) following Sachs et al (2020). Box plot displays the quartiles of the index (the middle line is the median) for EMDs in Asia and Caribbean countries.

While still one of the most vulnerable among peers, climate readiness and vulnerability have improved.

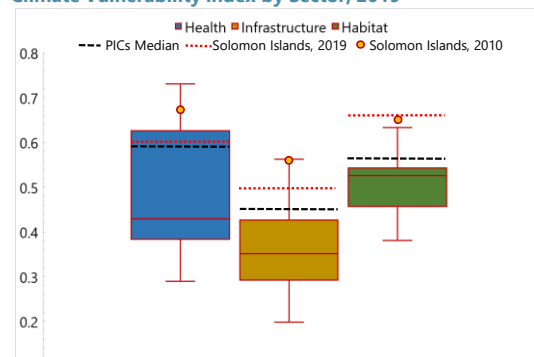
Climate Readiness and Vulnerability Indices, 2019



Source: Notre Dame Global Adaptation Initiative

But health, infrastructure, and settlements are still highly susceptible to extreme events compared with peers.

Climate Vulnerability Index by Sector, 2019



Source: Notre Dame Global Adaptation Initiative.

Note: Box plot displays the quartiles of the index (the middle line is the median) for FMDs in Asia

Table 1. Solomon Islands: Selected Economic Indicators, 2017–2026

Per capita GDP (2019): US\$2,215 (p)

Population (2019): 721,455 (p)

Quota: SDR 20.8 million

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
			Est.				Proj.			
GROWTH AND PRICES				Annual percentage change unless otherwise indicated						
Real GDP	5.3	3.9	1.2	-4.3	0.4	2.3	3.4	2.9	3.1	3.1
CPI (period average)	0.5	3.5	1.6	3.0	-0.2	3.8	3.5	3.6	3.5	3.5
CPI (end of period)	2.1	3.8	2.7	-2.5	3.1	3.2	3.4	3.5	3.5	3.5
GDP deflator	1.4	2.9	1.3	3.4	4.2	4.5	4.1	4.4	4.2	4.1
Nominal GDP (in SI\$ millions)	11,703	12,522	12,833	12,697	13,290	14,211	15,299	16,442	17,657	18,950
CENTRAL GOVERNMENT OPERATIONS				In percent of GDP						
Total revenue and grants	39.2	40.4	32.8	33.2	30.9	29.7	30.1	30.7	30.4	30.2
Revenue	30.2	30.5	26.4	24.4	22.3	23.0	24.1	24.9	24.6	24.5
Grants	9.0	9.9	6.4	8.8	8.6	6.7	6.1	5.8	5.8	5.7
Total expenditure	42.1	39.5	33.7	35.6	33.8	32.9	33.9	34.4	34.5	34.6
excluding grant-funded expenditure	33.1	29.6	27.3	26.9	25.2	26.2	27.8	28.6	28.8	28.9
Recurrent expenditure	29.2	29.5	25.6	29.3	26.8	24.2	24.2	24.3	24.4	24.4
Development expenditure	12.9	10.0	8.0	6.4	7.0	8.7	9.7	10.1	10.2	10.2
Unrecorded expenditure	-1.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-2.9	0.9	-0.9	-2.4	-2.9	-3.1	-3.8	-3.7	-4.2	-4.4
Foreign financing (net)	-0.3	-0.1	0.0	1.4	1.5	2.4	2.7	2.3	2.1	2.1
Domestic financing (net)	1.9	-0.8	0.9	1.0	1.4	0.7	1.1	1.4	2.1	2.3
Central government debt 1/	8.4	8.3	8.2	13.1	16.2	18.3	20.7	23.1	25.6	28.3
MACROFINANCIAL				Annual percentage change (end of year)						
Credit to private sector	6.4	4.1	6.1	0.3	1.0	4.0	7.0	6.0	5.5	5.0
Broad money	3.5	6.8	-3.1	6.6	3.4	3.6	4.3	4.0	3.8	4.1
Reserve money	7.5	10.6	-7.1	23.0	2.1	2.0	2.1	2.1	1.9	1.8
BALANCE OF PAYMENTS				In US\$ millions unless otherwise indicated						
Trade balance (goods and services)	-81.7	-67.6	-161.6	-127.4	-184.6	-308.7	-317.5	-291.3	-293.9	-322.9
(percent of GDP)	-5.5	-4.3	-10.3	-8.2	-11.2	-17.5	-16.7	-14.3	-13.4	-13.7
Current account balance	-62.8	-47.8	-154.0	-25.1	-85.2	-219.3	-233.6	-202.1	-200.3	-225.6
(percent of GDP)	-4.2	-3.0	-9.8	-1.6	-5.2	-12.4	-12.3	-9.9	-9.1	-9.6
Foreign direct investment (+ = decrease)	-35.9	-15.9	-28.7	-5.7	-24.1	-50.1	-58.2	-56.5	-57.3	-61.3
(percent of GDP)	-2.4	-1.0	-1.8	-0.4	-1.5	-2.8	-3.1	-2.8	-2.6	-2.6
Overall balance (+ = decrease)	-41.2	-57.4	33.8	-73.1	-39.6	59.6	57.1	33.0	24.4	35.5
Gross official reserves (in US\$ millions, end of period) 2/	576.9	613.1	574.1	660.6	700.3	640.9	588.9	565.7	547.2	513.7
(in months of next year's imports of GNFS)	9.3	9.8	12.4	13.5	10.9	9.0	8.5	8.1	7.5	6.7
EXCHANGE RATE (SI\$/US\$, end of period)	7.9	8.1	8.2	8.05	...	...	...	...	...	...
Real effective exchange rate (end of period, 2010 = 100)	126.4	126.5	127.2	129.7	...	...	...	...	...	...
MEMORANDUM ITEMS:										
Cash balance (in SI\$ millions)	343	311	206	206	104	104	104	104	104	104
in months of recurrent spending	1.5	1.2	0.8	0.8	0.4	0.4	0.4	0.3	0.3	0.3
SIG Deposit Account (In addition to cash balance, in SI\$ millions)	140	140	140	120	120	120	120	120	120	120
Broader cash balance (=Cash balance+ SIG Deposit Account; in SI\$ millions)	483	451	346	326	224	224	224	224	224	224
in months of total spending 3/	1.5	1.5	1.2	1.1	0.8	0.7	0.6	0.6	0.5	0.5
Public domestic debt, including arrears (in SI\$ millions)	193	245	273	452	747	843	1,010	1,244	1,620	2,054

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

1/ Includes disbursements under the IMF-supported programs.

2/ Includes SDR allocations made by the IMF to Solomon Islands in 2009 and in 2021, and actual and prospective disbursements under the IMF-supported programs.

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

Table 2a. Solomon Islands: Summary of Fiscal Accounts, 2017–2026
(in millions of Solomon Islands dollars)

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
	Act.	Act	Act.	Est.	Revised Budget	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	4,592	5,058	4,207	4,218	4,072	4,108	4,224	4,609	5,051	5,360
Total revenue	3,534	3,815	3,391	3,103	3,018	2,960	3,270	3,680	4,093	4,338
Tax revenue	2,954	3,275	2,871	2,643	2,593	2,556	2,818	3,167	3,536	3,742
Income and profits	1,028	1,090	1,049	1,008	992	976	1,090	1,256	1,437	1,552
Goods and services	878	1,095	937	924	938	938	1,027	1,178	1,347	1,480
International trade and transactions	1,048	1,090	886	711	663	642	701	733	752	710
<i>Of which: Tax on logging</i>	629	790	581	477	406	378	422	412	410	408
Other revenue	579	540	520	461	426	404	452	513	556	596
Grants	1,058	1,243	816	1,115	1,054	1,148	954	930	958	1,022
Development grants	471	584	520	585	431	526	646	664	673	718
Budget Support grants	587	659	296	530	623	623	308	266	285	304
Expenditure	4,930	4,950	4,320	4,526	4,496	4,491	4,672	5,189	5,657	6,099
Of which: excluding grant-funded expenditure	3,872	3,707	3,505	3,411	3,443	3,343	3,717	4,259	4,699	5,077
Recurrent expenditure	3,415	3,696	3,287	3,719	3,556	3,556	3,439	3,706	3,994	4,303
Of which: excluding grant-funded expenditure	2,828	3,037	2,992	3,189	2,934	2,934	3,131	3,440	3,709	3,998
Compensation of employees	1,113	1,169	1,231	1,292	1,290	1,290	1,357	1,461	1,570	1,686
Interest payments	169	70	53	25	40	41	64	73	89	109
Other recurrent expenditure	2,134	2,320	2,003	2,402	2,226	2,225	2,018	2,172	2,335	2,507
Government funded	1,547	1,661	1,707	1,872	1,604	1,603	1,710	1,906	2,050	2,203
Grant-funded	587	659	296	530	623	623	308	266	285	304
Development expenditure	1,515	1,254	1,033	807	940	935	1,232	1,483	1,663	1,796
Government funded development expenditure	1,044	670	513	373	509	409	586	819	990	1,079
Domestic	1,007	626	451	194	137	207	239	407	617	716
External loan	37	44	62	179	372	201	347	412	372	363
Grant funded	471	584	520	434	431	526	646	664	673	718
Of which: CDFs	374	380	209	240	342	342	342	368	396	425
Current balance 1/	705	778	399	-86	85	26	139	240	383	339
Primary balance	-170	178	-61	-283	-384	-341	-383	-506	-517	-630
Overall balance	-339	108	-114	-308	-424	-382	-447	-579	-606	-739
Total financing	339	-108	114	308	424	382	447	579	606	739
Foreign (net)	-36	-11	4	179	199	201	347	412	372	363
Disbursements	37	44	62	460	243	243	391	493	493	456
Amortization	-73	-55	-58	-44	-44	-41	-44	-81	-121	-93
Domestic (net)	375	-98	110	129	226	181	100	167	234	376
Of which : Change in narrow cash balance (+ =decrease)	69	33	104	1	0	102	0	0	0	0
Change in public domestic debt (+ =increase)	150	53	28	179	0	295	96	167	234	376
Memorandum items:										
Nominal GDP (in SI\$ millions)	11,703	12,522	12,833	12,697	13,290	13,290	14,211	15,299	16,442	17,657
Public domestic debt, including arrears (in SI\$ millions)	193	245	273	452	452	747	843	1,010	1,244	1,620
Narrow cash balance (in SI\$ millions) 2/	343	311	206	206	206	104	104	104	104	104
in months of recurrent spending 3/	1.5	1.2	0.8	0.8	0.8	0.4	0.4	0.4	0.3	0.3
SIG Deposit Account and others (in SI\$ millions)	140	140	140	120	120	120	120	120	120	120
Broader cash balance (in SI\$ millions)	483	451	346	326	326	224	224	224	224	224
in months of total spending 4/	1.5	1.5	1.2	1.1	1.1	0.8	0.7	0.6	0.6	0.5
Accumulated domestic arrears (in SI\$ million)	138	0	0	100	0	0	0	0	0	0
Non-commodity primary balance 5/ (in SI\$ millions)	-799	-612	-642	-760	-791	-719	-815	-933	-963	-1,076

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

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

2/ Defined as the sum of government deposits held at the CBSI and the commercial banks minus unpaid payment orders and unrepresented checks. From 2016 onward, deposits held at the CBSI and the commercial banks have used as a proxy for the narrow cash reserve

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

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

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

Table 2b. Solomon Islands: Summary of Fiscal Accounts, 2017–2026
(in percent of GDP)

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
	Act.	Act.	Act.	Proj.	Original Budget	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	39.2	40.4	32.8	33.2	30.6	30.9	29.7	30.1	30.7	30.4
Total revenue	30.2	30.5	26.4	24.4	22.7	22.3	23.0	24.1	24.9	24.6
Tax revenue	25.2	26.2	22.4	20.8	19.5	19.2	19.8	20.7	21.5	21.2
Income and profits	8.8	8.7	8.2	7.9	7.5	7.3	7.7	8.2	8.7	8.8
Goods and services	7.5	8.7	7.3	7.3	7.1	7.1	7.2	7.7	8.2	8.4
International trade and transactions	9.0	8.7	6.9	5.6	5.0	4.8	4.9	4.8	4.6	4.0
<i>Of which:</i> Tax on logging	5.4	6.3	4.5	3.8	3.1	2.8	3.0	2.7	2.5	2.3
Other revenue	5.0	4.3	4.0	3.6	3.2	3.0	3.2	3.4	3.4	3.4
Grants	9.0	9.9	6.4	8.8	7.9	8.6	6.7	6.1	5.8	5.7
Development grants	4.0	4.7	4.1	4.6	3.2	4.0	4.5	4.3	4.1	4.0
Recurrent budget grants	5.0	5.3	2.3	4.2	4.7	4.7	2.2	1.7	1.7	1.7
Expenditure	42.1	39.5	33.7	35.6	33.8	33.8	32.9	33.9	34.4	34.5
<i>Of which:</i> excluding grant-funded expenditure	33.1	29.6	27.3	26.9	25.9	25.2	26.2	27.8	28.6	28.9
Recurrent expenditure	29.2	29.5	25.6	29.3	26.8	26.8	24.2	24.2	24.3	24.4
<i>Of which:</i> excluding grant-funded expenditure	24.2	24.3	23.3	25.1	22.1	22.1	22.0	22.5	22.6	22.7
Compensation of employees	9.5	9.3	9.6	10.2	9.7	9.7	9.5	9.5	9.5	9.5
Interest payments	1.4	0.6	0.4	0.2	0.3	0.3	0.5	0.5	0.5	0.6
Other recurrent expenditure	18.2	18.5	15.6	18.9	16.8	16.7	14.2	14.2	14.2	14.2
Government funded	13.2	13.3	13.3	14.7	12.1	12.1	12.0	12.5	12.5	12.5
Grant funded	5.0	5.3	2.3	4.2	4.7	4.7	2.2	1.7	1.7	1.7
Development expenditure	12.9	10.0	8.0	6.4	7.1	7.0	8.7	9.7	10.1	10.2
Government funded	8.9	5.4	4.0	2.9	3.8	3.1	4.1	5.4	6.0	6.1
Domestic	8.6	5.0	3.5	1.5	1.0	1.6	1.7	2.7	3.8	4.1
External loan	0.3	0.4	0.5	1.4	2.8	1.5	2.4	2.7	2.3	2.1
Grant funded	4.0	4.7	4.1	3.4	3.2	4.0	4.5	4.3	4.1	4.0
<i>Of which:</i> CDFs	3.2	3.0	1.6	1.9	2.6	2.6	2.4	2.4	2.4	2.4
Current balance 1/	6.0	6.2	3.1	-0.7	0.6	0.2	1.0	1.6	2.3	1.9
Primary balance	-1.5	1.4	-0.5	-2.2	-2.9	-2.6	-2.7	-3.3	-3.1	-3.6
Overall balance	-2.9	0.9	-0.9	-2.4	-3.2	-2.9	-3.1	-3.8	-3.7	-4.4
Total financing	2.9	-0.9	0.9	2.4	3.2	2.9	3.1	3.8	3.7	4.2
Foreign (net)	-0.3	-0.1	0.0	1.4	1.5	1.5	2.4	2.7	2.3	2.1
Disbursements	0.3	0.4	0.5	3.6	1.8	1.8	2.7	3.2	3.0	2.6
Amortization (accrual)	-0.6	-0.4	-0.4	-0.3	-0.3	-0.3	-0.3	-0.5	-0.7	-0.5
Domestic (net)	3.2	-0.8	0.9	1.0	1.7	1.4	0.7	1.1	1.4	2.1
<i>Of which:</i> Change in cash balance (+ = decrease)	0.6	0.3	0.8	0.0	0.0	0.8	0.0	0.0	0.0	0.0
Change in public domestic debt (+ = increase)	1.3	0.4	0.2	1.4	0.0	2.2	0.7	1.1	1.4	2.1
Memorandum items:										
Accumulated domestic arrears (In percent of GDP)	1.2	0.0	0.0	0.8	0.0	0.0	0.0	0.0	0.0	0.0
Public domestic debt, including arrears (In percent of GDP)	1.6	2.0	2.1	3.6	3.4	5.6	5.9	6.6	7.6	9.2
Non-commodity primary balance 2/ (In percent of GDP)	-6.8	-4.9	-5.0	-6.0	-5.9	-5.4	-5.7	-6.1	-5.9	-6.0

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

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

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

Table 3. Solomon Islands: Balance of Payments, 2017–2026

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
				Est.	Proj.					
(In millions of U.S. dollars)										
Current account balance	-62.8	-47.8	-154.0	-25.1	-85.2	-219.3	-233.6	-202.1	-200.3	-225.6
Trade balance for goods	7.2	6.5	-36.4	-25.3	-76.5	-163.0	-193.1	-161.9	-169.9	-192.5
Exports	469.3	536.0	460.9	378.7	358.4	393.7	403.3	417.0	422.1	431.4
Logs	312.4	372.9	318.6	245.5	215.9	224.1	218.8	217.8	216.6	215.3
Fish	48.7	56.2	49.6	43.5	51.2	57.4	63.2	68.6	73.6	76.8
Minerals	16.8	19.0	19.8	18.1	14.7	21.5	25.1	27.2	27.6	28.1
Other	91.4	87.9	73.0	71.7	76.7	90.8	96.2	103.5	104.3	111.1
Imports	462.1	529.4	497.3	404.0	435.0	556.7	596.4	579.0	592.1	623.9
Trade balance for services	-88.9	-74.1	-125.3	-102.1	-108.0	-145.7	-124.5	-129.3	-123.9	-130.4
Exports	128.9	144.7	130.4	50.1	46.2	69.8	133.3	119.8	121.8	124.7
Imports	217.8	218.8	255.6	152.2	154.3	215.5	257.8	249.1	245.7	255.1
Income balance	-33.3	-20.4	-16.4	35.8	21.8	19.5	17.1	15.7	17.5	13.3
Credits	41.0	42.5	49.9	56.6	54.4	55.0	56.8	59.6	62.2	65.6
Debits	74.3	63.0	66.3	20.8	32.6	35.5	39.7	43.8	44.7	52.4
Current transfers balance	52.2	40.2	24.0	66.5	77.5	69.9	66.8	73.5	76.1	84.0
Of which: Official transfers, net	61.1	50.5	54.3	71.3	75.9	61.9	56.8	49.2	44.7	47.3
Capital account balance	59.6	60.0	63.6	62.3	65.4	80.3	82.5	83.7	89.2	95.0
Credits	59.6	60.0	63.6	62.3	65.4	80.3	82.5	83.7	89.2	95.0
Debit	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance (excludes reserve assets)	-39.6	-17.6	-20.4	-7.2	-59.5	-79.4	-94.0	-85.3	-86.7	-95.1
Direct investment balance	-35.9	-15.9	-28.7	-5.7	-24.1	-50.1	-58.2	-56.5	-57.3	-61.3
Outwards	7.0	9.1	4.0	3.3	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6
Inwards	42.9	25.0	32.8	9.0	23.5	49.5	57.6	55.9	56.7	60.7
Portfolio investment balance	2.1	-0.2	3.9	1.5	0.0	0.0	0.0	0.0	0.0	0.0
Other investment balance	-5.8	-1.5	4.5	-3.0	-35.4	-29.3	-35.8	-28.9	-29.4	-33.8
Assets	4.9	6.0	-1.1	10.7	9.7	6.2	10.6	17.6	12.2	7.6
of which, amortization of official loans	-9.0	-6.9	-7.0	5.4	5.1	5.4	10.0	14.9	11.4	7.0
Liabilities	10.7	7.5	-5.5	13.6	45.1	35.6	46.3	46.5	41.6	41.4
of which, disbursement of official loans (incl. SDR)	18.0	9.0	7.6	32.5	55.1	48.6	61.3	61.3	56.6	56.4
Errors and omissions	4.8	27.5	36.2	28.6	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-41.2	-57.4	33.8	-73.1	-39.6	59.6	57.1	33.0	24.4	35.5
Financing	-41.2	-57.4	33.8	-73.1	-39.6	59.6	57.1	33.0	24.4	35.5
Change in gross reserves (- = increase)	-44.1	-60.9	31.6	-44.4	-39.6	59.3	52.1	23.2	18.5	33.5
Net use of IMF Credit	-3.0	-3.5	-2.1	28.6	0.0	-0.3	-5.0	-9.8	-5.9	-2.0
Of which: IMF Disbursements 2/	0.0	0.0	0.0	28.8	0.0	0.0	0.0	0.0	0.0	0.0
Of which: Repayments to the IMF	-3.0	-3.5	-2.1	-0.2	0.0	-0.3	-5.0	-9.8	-5.9	-2.0
Other Financing (net of IMF credit) 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(In percent of GDP, unless otherwise indicated)										
Current account	-4.2	-3.0	-9.8	-1.6	-5.2	-12.4	-12.3	-9.9	-9.1	-9.6
Trade balance for goods	0.5	0.4	-2.3	-1.6	-4.6	-9.2	-10.2	-7.9	-7.7	-8.2
Exports	31.6	34.0	29.4	24.5	21.7	22.3	21.2	20.4	19.2	18.3
Imports	31.1	33.6	31.7	26.1	26.3	31.5	31.4	28.3	27.0	26.5
Trade balance for services	-6.0	-4.7	-8.0	-6.6	-6.5	-8.2	-6.5	-6.3	-5.6	-5.5
Income balance	-2.2	-1.3	-1.0	2.3	1.3	1.1	0.9	0.8	0.8	0.6
Current transfers balance	3.5	2.6	1.5	4.3	4.7	4.0	3.5	3.6	3.5	3.6
Of which: Official transfers net	4.1	3.2	3.5	4.6	4.6	3.5	3.0	2.4	2.0	2.0
Capital account balance	4.0	3.8	4.1	4.0	4.0	4.5	4.3	4.1	4.1	4.0
Direct investment balance	-2.4	-1.0	-1.8	-0.4	-1.5	-2.8	-3.1	-2.8	-2.6	-2.6
Of which: Inward FDI	2.9	1.6	2.1	0.6	1.4	2.8	3.0	2.7	2.6	2.6
Other investment balance	-0.4	-0.1	0.3	-0.2	-2.1	-1.7	-1.9	-1.4	-1.3	-1.4
Memorandum items										
Gross official foreign reserves (in US\$ million) 3/	577	613	574	661	700	641	589	566	547	514
In months of next year's imports of GNFS	9.3	9.8	12.4	13.5	10.9	9.0	8.5	8.1	7.5	6.7
Gross external public debt (in percent of GDP)	6.8	6.2	6.1	9.8	10.7	12.4	14.2	15.5	16.5	17.5
Disbursement of concessional borrowing (in US\$ millions)	12.6	5.6	16.5	86.4	97.4	65.7	51.2	46.9	44.6	44.6
External public debt service (in percent of exports of GNFS)	1.7	1.1	1.4	1.5	1.8	1.8	2.5	3.5	3.0	2.1
Nominal GDP (in US\$ millions)	1483.8	1574.6	1570.2	1545.9	1651.9	1766.4	1901.6	2043.8	2194.8	2355.5

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

1/ The presentation follows the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6)

2/ Includes 100% of Fund quota of which 1/3 as RCF and 2/3 as RFI.

3/ Includes SDR allocations made by the IMF to Solomon Islands in 2009 and in 2021, and actual and prospective disbursements under the IMF-supported programs.

Table 4. Solomon Islands: Summary Accounts of the Banking System 2017–2026

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
					Proj.					
(In millions of Solomon Islands dollars, end of period)										
Central Bank of Solomon Islands (CBSI)										
Net foreign assets (NFA)	4,366	4,834	4,580	4,949	5,045	4,567	4,148	3,962	3,813	3,543
Net international reserves (NIR)	4,481	4,957	4,696	5,065	5,390	4,912	4,493	4,307	4,158	3,888
Other NFA	-115	-123	-115	-116	-345	-345	-345	-345	-345	-345
Net domestic assets (NDA)	-1,583	-1,758	-1,722	-1,434	-1,454	-907	-412	-147	73	413
Net claims on central government	-963	-1,026	-860	-784	-622	-562	-562	-562	-562	-562
Claims	5	5	6	65	125	185	185	185	185	185
Deposits	968	1,032	866	850	747	747	747	747	747	747
Other items (net)	143	136	172	182	171	171	171	171	171	171
Reserve money	2,783	3,077	2,859	3,515	3,590	3,661	3,737	3,815	3,886	3,957
Currency in circulation	896	908	910	1,095	1,146	1,225	1,319	1,418	1,523	1,634
Bank deposits	1,875	2,158	1,934	2,409	2,433	2,423	2,404	2,383	2,348	2,306
Other deposits	12	11	14	11	12	12	13	14	15	16
Other depository corporations										
NFA of commercial banks	217	218	201	364	167	175	183	190	198	207
Assets	323	439	427	504	512	519	527	535	543	551
Liabilities	106	221	226	140	345	345	345	345	345	345
NDA of commercial banks	1,909	1,949	2,023	1,539	1,843	1,967	2,134	2,289	2,452	2,642
Net claims on central government	-265	-257	-277	-364	-364	-264	-289	-354	-437	-520
Claims	17	25	33	45	45	37	12	-53	-136	-219
Deposits	282	282	310	408	408	301	301	301	301	301
Claims on the private sector	2,363	2,460	2,607	2,613	2,640	2,745	2,937	3,114	3,285	3,449
Other items (net)	-190	-253	-307	-710	-432	-515	-514	-470	-396	-287
Reserves and vault cash	1,950	2,238	2,017	2,479	2,569	2,568	2,560	2,551	2,529	2,500
Deposits	4,076	4,406	4,242	4,383	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Depository corporations survey										
NFA of the banking system	4,583	5,053	4,781	5,313	5,212	4,742	4,331	4,152	4,011	3,750
Central bank	4,366	4,834	4,580	4,949	5,045	4,567	4,148	3,962	3,813	3,543
Other depository corporations	217	218	201	364	167	175	183	190	198	207
NDA of the banking system	326	192	301	106	389	1,060	1,722	2,142	2,525	3,055
Net claims on central government	-1,228	-1,283	-1,137	-1,148	-985	-825	-850	-916	-999	-1,082
Claims on the private sector 2/	2,372	2,469	2,621	2,629	2,656	2,762	2,954	3,130	3,301	3,466
Other items (net)	-818	-994	-1,183	-1,375	-1,282	-877	-381	-72	222	671
Broad money (M3)	4,909	5,244	5,082	5,418	5,601	5,802	6,053	6,294	6,536	6,805
M1	3,648	3,936	3,848	4,334	4,536	4,754	5,014	5,214	5,414	5,637
Currency outside banks	821	828	828	1,025	1,010	1,080	1,163	1,250	1,342	1,440
Demand deposits	2,827	3,108	3,020	3,308	3,526	3,674	3,852	3,964	4,072	4,197
Savings and time deposits	1,260	1,307	1,234	1,085	1,065	1,048	1,039	1,080	1,122	1,168
(Annual percentage change, unless otherwise indicated)										
Reserve money	7.5	10.6	-7.1	23.0	2.1	2.0	2.1	2.1	1.9	1.8
Credit to the private sector	6.4	4.1	6.1	0.3	1.0	4.0	7.0	6.0	5.5	5.0
Broad money	3.5	6.8	-3.1	6.6	3.4	3.6	4.3	4.0	3.8	4.1
Memorandum items:										
Money multiplier (level)	1.8	1.7	1.8	1.5	1.6	1.6	1.6	1.7	1.7	1.7
Loan-to-deposit ratio (in percent)	58.0	55.8	61.5	59.6	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Interest rates (percent per annum)										
Deposit rate 3/	0.3	0.3	0.4	0.5	...	...	...	...	...	...
Lending rate 3/	10.6	10.5	10.4	10.7	...	...	...	...	...	...
NCG of financial corporations	-1,044	-1,097	-951	-782	-329	-169	-2	232	609	N.A.
91-day treasury bill rate	0.5	0.5	0.5	0.5	...	...	...	...	...	...

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

1/ Based on actual and projected exchange rates.

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

3/ Weighted average of different maturities, period average.

Table 5. Solomon Islands: Indicators of Capacity to Repay the Fund, 2021–2031

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
	Proj.										
Fund obligations based on existing credit (in SDR millions)											
Principal	0.0	0.2	3.6	7.1	4.2	1.4	1.4	1.4	1.4	0.7	0.0
Charges and interest	0.0	0.2	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fund obligations based on prospective credit (in SDR millions) 1/											
Principal	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Fund obligations based on existing and prospective credit (in SDR millions) 1/											
Principal	0.0	0.2	3.6	7.1	4.2	1.4	1.4	1.4	1.4	0.7	0.0
Charges and interest	0.0	0.2	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total obligations based on existing and prospective credit											
In millions of SDRs	0.0	0.2	3.6	7.1	4.2	1.4	1.4	1.4	1.4	0.7	0.0
In millions of US\$	0.0	0.3	5.0	9.8	5.9	2.0	1.9	1.9	1.9	1.0	0.0
In percent of gross international reserves	0.0	0.0	0.9	1.7	1.1	0.4	0.4	0.5	0.6	0.4	0.0
In percent of government revenue	0.0	0.1	0.9	1.6	0.9	0.3	0.3	0.2	0.2	0.1	0.0
In percent of exports of goods and services	0.0	0.1	0.9	1.8	1.1	0.4	0.3	0.3	0.3	0.2	0.0
In percent of debt service 2/	0.0	2.8	34.9	48.6	33.2	14.8	13.7	13.1	11.1	5.3	0.0
In percent of GDP	0.0	0.0	0.3	0.5	0.3	0.1	0.1	0.1	0.1	0.0	0.0
In percent of quota	0.0	0.9	17.5	34.0	20.3	6.8	6.7	6.7	6.7	3.3	0.0
Outstanding Fund credit 1/											
In millions of SDRs	21.4	21.2	17.6	10.5	6.3	4.9	3.5	2.1	0.7	0.0	0.0
In millions of US\$	29.7	29.4	24.4	14.6	8.7	6.7	4.8	2.9	1.0	0.0	0.0
In percent of gross international reserves	4.2	4.6	4.1	2.6	1.6	1.3	1.0	0.7	0.3	0.0	0.0
In percent of government revenue	5.8	5.6	4.3	2.3	1.3	0.9	0.6	0.4	0.1	0.0	0.0
In percent of exports of goods and services	7.3	6.3	4.5	2.7	1.6	1.2	0.8	0.5	0.2	0.0	0.0
In percent of debt service 1/	361.7	316.4	169.0	72.1	49.2	50.4	34.1	19.7	5.5	0.0	0.0
In percent of GDP	1.8	1.7	1.3	0.7	0.4	0.3	0.2	0.1	0.0	0.0	0.0
In percent of quota	102.8	101.9	84.5	50.5	30.1	23.3	16.7	10.0	3.3	0.0	0.0
Net use of Fund credit (in SDR millions)	0.0	-0.2	-3.6	-7.1	-4.2	-1.4	-1.4	-1.4	-1.4	-0.7	0.0
Disbursements	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments and repurchases	0.000	-0.190	-3.630	-7.070	-4.230	-1.420	-1.390	-1.390	-1.390	-0.690	0.000
Memorandum items:											
Nominal GDP (in US\$ millions)	1651.9	1766.4	1901.6	2043.8	2194.8	2355.5	2525.9	2701.3	2896.8	3108.1	3332.2
Exports of goods and services (in US\$ millions)	404.7	463.5	536.6	536.8	543.9	556.1	568.7	582.2	597.3	611.8	627.0
Gross international reserves (in US\$ millions)	700.3	640.9	588.9	565.7	547.2	513.7	467.5	403.7	340.4	272.6	187.1
Government revenue (in US\$ millions)	510.7	525.1	572.9	627.8	666.2	712.0	755.4	799.5	848.3	902.7	960.2
Debt service (in US\$ millions) 2/	8.2	9.3	14.4	20.2	17.7	13.3	14.1	14.7	17.3	18.0	20.6
SI/U.S. dollars (period average)	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0
U.S. dollars/SDR (period average)	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4
Quota (in SDR millions)	20.8	20.8	20.8	20.8	20.8	20.8	20.8	20.8	20.8	20.8	20.8

Source: IMF staff estimates and projections.

1/ Total public debt service, including IMF repayments.

Annex I. Risk Assessment Matrix¹

Likelihood	Impact / Time Horizon		Policy Response
Medium	Medium-High / ST, MT	Upside	<ul style="list-style-type: none"> Take advantage of upside surprises to lock in an improvement in fiscal buffers. Consider ways to use some of the gains to invest in resilient infrastructure and progress towards SDGs.
	1. Faster containment of the Covid-19 pandemic Pandemic is contained faster than expected due to the rapid production and distribution of vaccines, boosting confidence and economic activity		
Medium	High / ST, MT	Downside	<ul style="list-style-type: none"> Increase public expenditure in health infrastructure, education, and social safety nets to mitigate the immediate impact of the pandemic and boost potential growth. Cushion the impact. Seek additional concessional financing to ensure that critical capital expenditure projects can continue. Review and realign the basket exchange rate peg with underlying fundamentals and competitiveness. Undertake structural reforms to improve the business environment and help support diversification of the sources of growth. Sustain the fiscal buffer. Make efforts to contain spending on CDFs. Contain spending on the Pacific Games and ensure financing is grants or on concessional terms.
	2. Positive spillovers from large infrastructure projects The implementation of the long-standing plans for large infrastructure projects, such as the Tina Hydropower development project, could have positive spillovers on the economy from 2022 onwards.		
Medium	High / ST, MT		
	1. Covid-19 local outbreaks Given weaknesses in health infrastructure, any domestic community transmission of the virus could lead to a significant increase in human and economic costs.		
Medium	High / ST		
	2. Global resurgence of the Covid-19 pandemic. Local outbreaks lead to a global resurgence of the pandemic (possibly due to vaccine-resistant variants), which requires costly containment efforts and prompts persistent behavioral changes rendering many activities unviable.		
High	High / ST, MT		
	3. Fiscal policy slippages, including spending on the Pacific Games. Expansionary fiscal policy and weak public financial management increase domestic arrears, resulting in a rise in non-performing loans in the banking sector.		
High	Medium / ST		
	4. Social discontent and political instability. Social discontent could increase as the pandemic and lockdowns exacerbate pre-existing inequalities, causing socio-economic hardship (unemployment, poverty, and shortages and higher prices of essentials).		
Medium	Medium / ST		<ul style="list-style-type: none"> Finalize and complete the Tina Hydro project which will reduce dependence on oil imports and could help reduce electricity prices.
	5. Rising commodity prices amid bouts of volatility. Commodity prices increase by more than expected against a weaker U.S. dollar, post-pandemic pent-up demand and supply disruptions, and for some materials, accelerated plans for renewable energy adoption. Uncertainty surrounding each of these factors leads to bouts of volatility, especially in oil prices.		
Medium	High / ST		<ul style="list-style-type: none"> Reduce environmental concerns in the logging sector. Continue to strengthen prudential standards for governance, fit and proper. Strengthen the effectiveness of the AML/CFT framework. Contribute to regional efforts to mitigate CBR pressures, including establishment of a regional Know Your Customer Utility.
	6. Reduced financial services by correspondent banks AML/CFT and governance vulnerabilities increase the cost and/or reduce access to correspondent banking services.		
Medium/ High	High / ST, MT		<ul style="list-style-type: none"> Build fiscal buffers against a natural disaster shock. Use space available in the aftermath of a shock to ease the fiscal policy stance and provide a social safety net for those affected. Plan how to adjust back to target once the impact of the shock has diminished. Invest in resilient infrastructure to strengthen climate change mitigation and adaptation.
	7. Higher frequency and severity of natural disasters related to climate change Solomon Islands faces many natural disasters, including tropical cyclone, drought, earthquake, tsunami, and flood in the past. Disasters could occur with higher frequency and severity due to climate change. The country also faces the risk of adverse effects of volatile weather conditions caused primarily by global warming.		

¹ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("L" (low) is meant to indicate a probability below 10 percent, "M" (medium) a probability between 10 percent and 30 percent, and "H" (high) a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive

Annex II. External Sector Assessment¹

Overall Assessment: The external position of Solomon Islands in 2020 was moderately weaker than the level implied by medium term fundamentals and desirable policies. The current account (CA) deficit is expected to widen as the economy recovers from the pandemic and infrastructure projects accelerate. The real exchange rate was assessed as overvalued. Reserve coverage remains strong but is expected to decline over time.

Potential Policy Responses: Structural policies remain the cornerstone to improve competitiveness and encourage export diversification, while sound fiscal policies can help reduce the CA gap. Continuing to pursue grant financing and highly concessional loans will reduce the pressure on debt accumulation and limit financing costs. The regular revision of the basket of currencies in the exchange rate regime and the intervention currency can help prevent persistent exchange rate misalignments.

Foreign Assets and Liabilities: Position and Trajectory

Background. As of the end of 2020, Solomon Islands net international investment position (NIIP) has improved to 0.7 percent of GDP. In the past five years, the NIIP has remained low as a percentage of GDP, with the country alternating as net creditor and net debtor. Between 2016 and 2020, reserve assets have remained around 80 percent of gross assets; while on the liabilities side, foreign direct investment (FDI) represents over 70 percent of liabilities and general government debt has been growing towards 15 percent.

Assessment. The CA deficit is expected to widen in the near and medium term, and the NIIP-to-GDP ratio is expected to weaken. External debt accounts for 74 percent of total debt, mostly in concessional terms, with multilateral creditors and denominated in foreign currency. The structure of the external balance sheet entails low vulnerabilities, given the large share of FDI liabilities and the lack of portfolio liabilities.

2020 (% GDP)	NIIP: 0.7	Gross Assets: 54.0	Debt Assets: 7.3	Gross Liabilities.: 53.3	Debt Liabilities.: 21.0
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Current Account

Background. The CA deficit was 1.6 percent of GDP in 2020, reflecting the effect of the COVID-19 pandemic with imports falling by more than exports and strong income transfers. Prior to the pandemic, the CA deficit had been increasing, driven by decreasing logging exports and increasing service-related imports linked to infrastructure projects. In 2021 the CA is expected to worsen, mostly driven by the faster recovery of imports across all categories.

Assessment. The revised EBA-lite CA model indicates a negative gap of 1.2 percent of GDP, consistent with an adjusted CA balance of -3.1 percent and an adjusted CA norm of -2 percent.¹ The CA in 2020 is assessed to be weaker than that consistent with medium-term fundamentals and desirable policy settings. Based on the CA model, the policy gap has offset the overall CA gap by 6.6 percentage points. The domestic drivers of the policy gap were fiscal policy and reserves accumulation, while the relative gap with respect to the rest of the world explains most of the policy gap. The adjusted CA includes the COVID-19 adjustor to capture the unusual transitory effects of the

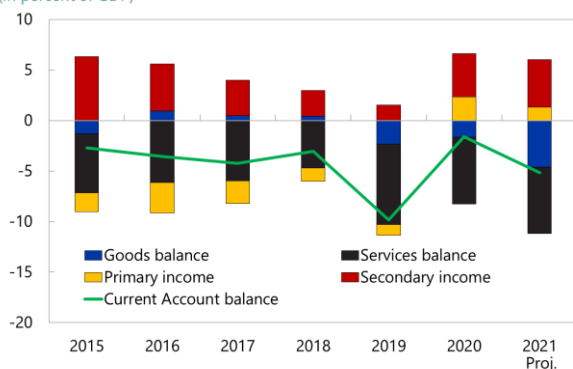
¹ See [The Revised EBA-lite methodology \(2019\)](#). The revised EBA-lite does not fully capture the characteristics of small states, hence there is significant uncertainty around the estimates used.

¹ Prepared by Gabriela Cugat (APD)

pandemic, in particular through depressed investment income in the primary income account that led to an unusually large positive primary income balance.

Solomon Islands: Current Account

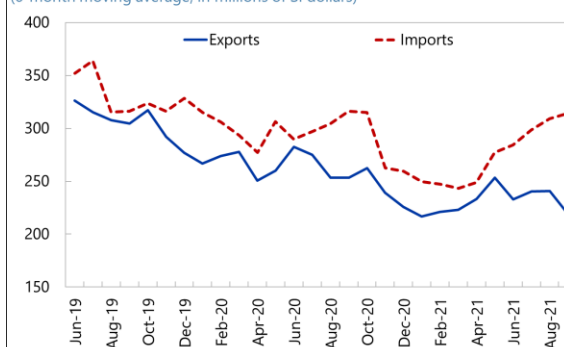
(In percent of GDP)



Sources: Solomon Islands authorities and IMF staff estimates.

Solomon Islands: Goods Trade

(6-month moving average, in millions of SI dollars)



Sources: Solomon Islands authorities and IMF staff calculations.

Solomon Islands: Model Estimates for 2020 (in percent of GDP)

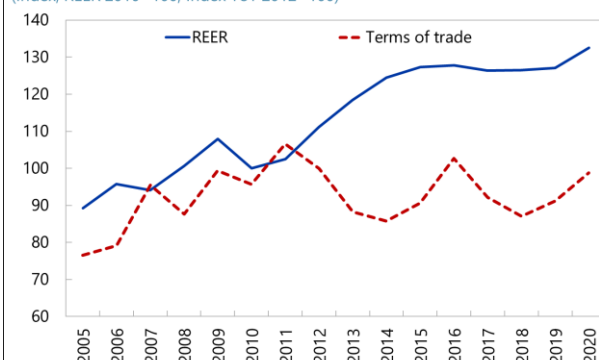
	CA model	REER model
CA-Actual	-1.6	
Cyclical contributions (from model) (-)	0.5	
COVID-19 adjustor (+) 1/	-1.1	
Adjusted CA	-3.1	
CA Norm (from model) 2/	-2.0	
Adjustments to the norm (+)	0.0	
Adjusted CA Norm	-2.0	
CA Gap	-1.2	-4.2
o/w Relative policy gap	6.6	
Elasticity	-0.29	
REER Gap (in percent)	3.9	14.2

1/ Additional cyclical adjustment to account for the temporary impact of the pandemic on oil trade balances (1.02 percent of GDP), on tourism (0.02 percent of GDP), remittances (-0.13 percent of GDP) and primary income (-2 percent of GDP).
2/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

Solomon Islands: REER and Terms of Trade

(Index, REER 2010=100; Index ToT 2012=100)



Source: IMF Staff calculations.

Background. The average real exchange rate appreciated by 4.3 percent in 2020, continuing the a long-run trend observed since 2005. The terms of trade improved in 2020 but raising competitiveness over the medium term remains a priority to promote growth and support foreign exchange reserves.

Assessment. The revised EBA-lite methodology using the CA approach suggests the real exchange rate is overvalued by 3.9 percent, while the REER approach suggests that the real exchange rate is overvalued by 14.2 percent compared to the REER norm in 2020. The policy gap accounts for 1 percent of the gap using the REER model.

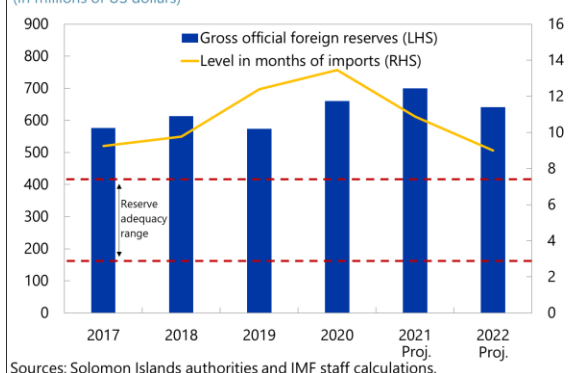
Capital and Financial Accounts: Flows and Policy Measures

Background. Until 2018, financing from the capital and financial accounts had been enough to finance the CA deficit and build up foreign exchange reserves, mostly supported by donor grants. Operations related to the capital account require previous CBSI approval. Net FDI flows represent the majority of the financial account, with FDI inflows being larger than outflows. In 2020 FDI inflows hit their lowest level since 2006, but donor support and the RCF/RFI emergency financing provided additional financing.

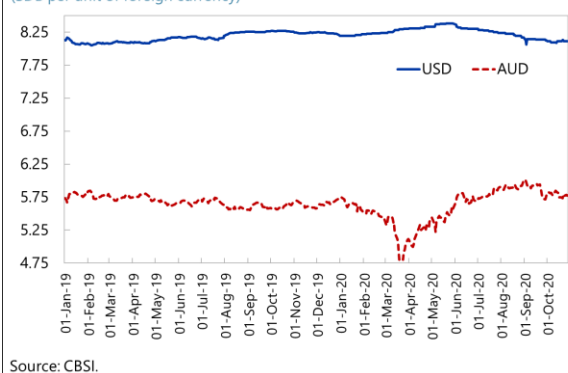
Assessment. FDI into Solomon Islands is expected to remain strong in the near term. However, the large financing needs, driven by the widening CA deficit, will require an increase in external debt. Pursuing grant financing and highly concessional loans can lessen the debt burden.

FX Intervention and Reserves Level

Official Foreign Exchange Reserves
(In millions of US dollars)



Bilateral Nominal Exchange Rates
(SDB per unit of foreign currency)



Background. Gross official reserves increased to US\$661 million in 2020, supported by the approved purchase under the RFI and the disbursement under the RCF in June 2020 and other donor inflows, covering 13.4 months of prospective imports. By end-October 2021, gross official reserves were US\$717 million, equivalent to 11.6 months of prospective imports. The authorities plan to keep the new SDR allocation of SDR19.94 million (about US\$25 million or 1.5 percent of GDP) as reserves. Strong official reserves have helped preserve macroeconomic stability amid elevated uncertainty while supporting the fixed exchange rate regime. The value of the Solomon Islands dollar is officially determined based on a trade-weighted basket of currencies comprising the US dollar, the Australian dollar, the Japanese yen, and the British pound. The value against the US dollar (the intervention currency) is set to maintain the value of the basket with respect to a base period while keeping the volatility of the basket within a base rate. As of end-October 2021, the nominal trade weighted currency basket that anchors the exchange rate regime has depreciated by 1.9 percent, mostly due to the nominal depreciation against the US dollar.

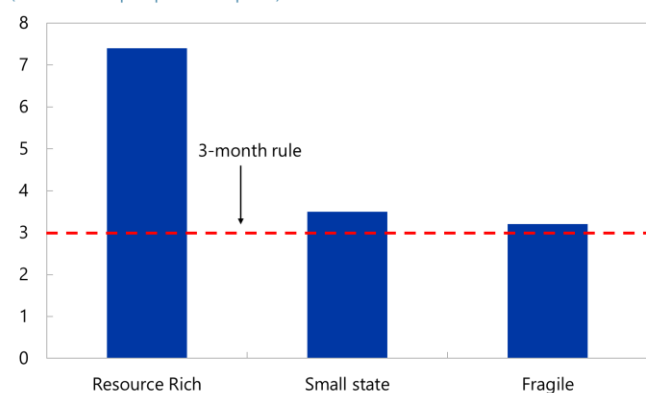
Assessment. Applying a cost-benefit analysis of holding reserves for Solomon Islands, the current level of reserves remains above the adequate level for a resource-rich, fragile, and small economy, assessed to be between 3 and 7.5 months of imports.² The reserve coverage is projected to decline over the medium term, to about seven months of

² See International Monetary Fund, Guidance Note on the Assessment of Reserve Adequacy and Related Considerations, Policy Paper, 2016. Given Solomon Islands' high vulnerability to shocks, the analysis used a probability of a large shock event of 0.66, which is higher than the sample average of 0.5. The wide range estimated for reserves adequacy is due to lower benefits from reserves accumulation for small and fragile states, this might be related to either the probability of the type of crises faced by these countries (mostly natural disasters) not being affected by reserves accumulation or having easier access to foreign aid, reducing the benefits for self-insurance.

prospective imports by 2026. While the coverage remains within the adequacy range, the government needs to maintain an adequate import coverage for infrastructure-related imports and to support the fixed exchange rate regime. Fostering sustainability in the forestry sector and exports diversification to reduce the CA deficit over the medium term can help slow down the decline in reserves. The periodic revision of the weights in the currency basket can prevent exchange rate misalignments, while updating the intervention currency can contribute to managing imported food price inflation and rebalancing foreign exchange risk across industries.

Solomon Islands: Reserve Adequacy Benchmarks 2020

(In months of prospective imports)



Source: IMF staff calculations.

Annex III. Promoting Digital Financial Inclusion: YouSave Lo Mobile¹

1. Solomon Islands labor force has few saving opportunities which creates a grim outlook come retirement. Close to 80 percent of the labor force works in the informal sector, with no access to social security from the National Provident Fund (NPF). The country lags peers in terms of financial development and inclusion, limiting opportunities to save for unexpected shocks and retirement. Increasing life expectancy coupled with such structural weaknesses leave most of the population in a vulnerable position for retirement. To address this issue, the NPF introduced in 2017 youSave, a micro pension scheme designed for self-employed and informal workers.²

2. YouSave is a voluntary savings scheme targeted at self-employed and informal workers, aimed at covering both short-term and retirement financial needs. The scheme was designed for workers that do not have an active NPF account and allows them to access the investment returns from the NPF. Contributions are split 50/50 between two types of personal accounts, a 'Preserved Account' that can only be accessed at age 55, and a 'General Account' that can be withdrawn from up to four times in a year. Accounts have no maintenance costs, and only a small initial deposit is required to activate the account. The scheme was first piloted in an innovation lab that allowed refining the product to increase uptake before it became too costly to maintain. The pilot identified targets for the operational costs to ensure self-sustainability and eventually profitability. While the uptake of the program was above target, geography was posing a challenge for making deposits as the deposit-taker agents were limited.

3. YouSave Lo Mobile, a public-private partnership to ease youSave transactions by taking advantage of digitalization was launched at end-2019. The new program was a collaboration of the government with the two Mobile Network Operators.³ Under this setup, youSave members can buy airtime from their nearest mobile agent and seamlessly convert it into a youSave deposit. Deposits through this channel have a 10 percent goods and services tax (that is later refunded into their youSave account) and a 5 percent network operation cost. While making deposits through youSave LoMobile has a cost, it has the convenience of being available from anywhere in the country where there is a mobile agent. As an added benefit, members can check their balance in real time for free.

4. YouSave Lo Mobile boosts financial inclusion by facilitating access to saving opportunities. The program allows workers in rural areas, such as fishermen and farmers, to cash their daily revenues into airtime and immediately transfer it into their account, without having to travel to Honiara to make a deposit. The program has provided much needed relief for financial

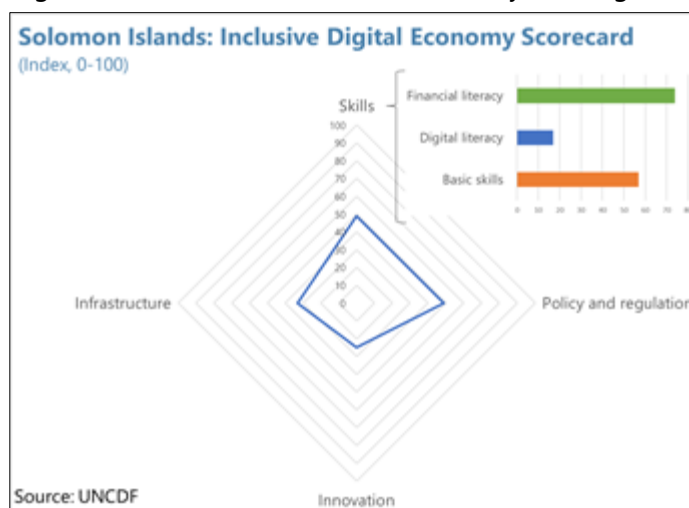
¹ Prepared by Gabriela Cugat (APD)

² The program benefited from technical assistance from the Pacific Islands Financial Inclusion Program -United Nations Capital Development (PFIP-UNCDF).

³ Specifically, it is a collaboration of the NPF, CBSI, SIG, Our Telekom and Bmobile, with technical assistance from the PFIP-UNCDF, UNDP Solomon Islands, and funding by the Australian Government.

needs during the pandemic, while allowing members to save for the long term. As of October 2021, there were 30,000 youSave members, out of which 53 percent were women. While historically women tend to be more serious savers in Solomon Islands, the program has also seen an increase in its male membership from 37 percent in 2017 to 47 percent in 2021. The NPF is currently working to make the scheme available for Solomon Islanders working overseas, particularly seasonal workers. When implementing this expansion, the authorities should ensure the appropriate AML/CFT mechanisms are put in place to satisfy customer due diligence requirements and mitigate money laundering risks in cross-border transactions.

5. Structural gaps in terms of efficiency, infrastructure, and literacy should be closed to facilitate digital financial inclusion. YouSave Lo Mobile showcases the potential for public-private partnerships in advancing financial inclusion in the digital era. To reduce costs for the government and improve efficiency, new partnerships could follow the youSave model (for example, by testing the product before scaling up, as well as identifying operational targets for sustainability and profitability). Further progress in breaching the geographical challenge of traditional financial services through digitalization relies on a network that functions well, without prohibitive costs, and users that have the skills to operate it. The UNCDF's Inclusive Digital Economy Scorecard pilot for Solomon Islands has identified infrastructure and innovation as the main weaknesses. Policy and regulation achieved a medium score, highlighting the government's past effort to make progress in these areas. In terms of skills, digital literacy lags both basic skills and financial literacy. The high score in financial literacy is likely a result of the National Financial Inclusion Strategies 1 and 2, that set specific targets in terms of provision and attendance of financial literacy programs. To take full advantage of the digital economy the government should continue prioritizing infrastructure projects that improve digital connectivity and increase digital literacy skills. Improving digital literacy should be promoted while targeting programs to groups where skills are limited.



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Peters, B., Coupienne, F., Kleiman, D. and Shah, S.: "Inclusive Digital Economy Scorecard Report Solomon Islands 2020", UNCDF, 2021.

Solomon Islands National Provident Fund, youSave Brochure.

-, youSave Press Release, February 27th, 2019.

-, youSave LoMobile Brochure.

-, youSave LoMobile, promotional spot, <https://www.youtube.com/watch?v=uDjTJmdLyD4>

Annex IV. TA Priorities for FY22-FY23

Topic	Sub-Topic	TA Description	Comments
Public Financial Management	Asset and liability management	Improved asset and liability management	TA will focus on implementing the roadmap for accounting and reporting of non-financial assets. A database for non-financial assets will be implemented and regular reporting on changes will be included in financial statements.
	Fiscal reporting	Improved coverage and quality of fiscal reporting	
	Public financial management laws and institutions.	Stronger PFM laws and institutions	
Revenue Administration	Revenue	Strengthened revenue	PFTAC will be providing TA on effective implementation of a new tax or modernized legislation and successful implementation of VAT in 2022. Initiatives will focus on improving on-time filing and payment obligations by taxpayers to strengthen voluntary compliance.
	Administration and Governance	administration, management, and governance arrangements	
	Tax administration core functions.	Strengthened core tax administration functions	
Tax Policy	Tax and non-tax revenue policy	Improved tax and non-tax revenue policy	Authorities would benefit from TA on domestic revenue mobilization, including MTRS and non-tax revenue including mineral pricing and associated revenue risks.
	MTRS	Develop an MTRS	
Financial Market Supervision and Regulation	Regulatory & Prudential Framework	Develop/strengthen banking regulations & prudential norms	Under the Supervision Framework Enhancement project, the CBSI with PFTAC's assistance has developed and implemented risk-based supervisory action planning process, risk rating model (including impact index), onsite examination framework and finalized applicable guidelines and regulations. The authorities could benefit from support on climate related considerations for financial sector supervision.
	Risk based supervision	To implement a risk-based supervision system and upgrade other supervisory processes.	
Debt Management	Medium term debt strategy and DSA workshop	Formulate and implement a medium-term debt management strategy	TA will focus on debt management strategies such as setting realistic targets or ranges for the evolution of interest rate, refinancing, and foreign currency risk. In addition, training will be provided to ensure staff are able to use the MTDS Analytical Tool (AT) effectively.

Central Bank Operations	FOREX reserve management.	Strengthen the reserve management policy framework and management of FX reserves	The Policy framework and guidelines have been developed and approved by the CBSI board in accordance with CB Law and with clearly defined strategic objectives. Authorities could benefit from TA on reviewing and drafting of the Exchange Control Act to align with best practices.
Macroeconomic and Financial Statistics	Real sector – National accounts, Input-Output tables, government finance, balance of payments, and data transparency	Strengthen compilation and dissemination of macro & financial statistics; implement the e-GDDS	TA and capacity development will continue in the compilation of GFS statistics, BOP, and GDP. Existing staff have been adequately trained on GDP rebasing. Authorities would benefit from TA on implementing the e-GDDS to enhance data transparency.
Economic Analysis and Modelling, Monetary Policy Framework and Communications (FPAS)	Monetary Policy, General Macroeconomic Analysis	Develop tools to improve economic analysis and forecasting capabilities, streamline the decision-making process, and strengthen the monetary policy communication strategy at the Central Bank	Support CBSI to develop analytical and forecasting capacity to improve economic analysis and forecasting capacities, modernize their monetary policy framework, and strengthen the communications.
Governance and Anti-Corruption	Anti-Corruption Legal, Regulatory and Institutional Frameworks	Strengthen the capacity of the Office of the Auditor General (OAG) in audits of emergency spending	Discuss existing legal frameworks and arrangements for auditing emergency spending and acting on findings, and recommendations for short term steps to enhance the ability to undertake compliance and other appropriate audits. Provide targeted capacity building to the OAG on the production, publishing, and follow-up of audits of emergency spending.

Annex V. Authorities' Response to Fund Policy Advice

Fund Recommendation	Policy Actions
Fiscal Policy	
Rebuilding cash buffers and prioritizing spending needs for progress towards SDGs	Authorities acknowledged their commitment to the MTDS and expect to rebuild buffers from 2021. They highlighted key reforms such as the National Payment System and PFM Procurement regulation and progress of the Tax Administration Bill and Customs Bill.
Increase fiscal openness, transparency, and planning	The 2021 budget and 2019 Final Budget Outcome documents have been published on the website.
Set up a MTRS	Tax reforms are progressing. Cabinet has approved the Tax Administration Bill. Consultation on the value-added tax (VAT) policy was carried out and the VAT bill is now ready for cabinet's endorsement.
Promote transparency and accountability of public funds, including CDFs	The Ministry of National Planning and Development Coordination has designed an output focused monitoring report with linkages to the development priorities and outcomes included in the National Development Strategy (NDS). In addition, government has set up a taskforce to review the CDF Act in compliance with the Public Finance Management Act.
Strengthen public financial management.	The Budget Coordination committee are mandated to ensure the delivery of 2021 Budget. Payment arrears re-emerged in 2020 and further improvements in cash management and expenditure control are needed.
Monetary and Financial Sector Policy	
Strengthen supervisory and regulatory framework for the financial system	There has been slow progress on the review of the Financial Institutions Act, the Credit Unions Act and the Insurance Act.
Strengthening the AML/CFT framework	Authorities have introduced a National Strategic Plan. Supervisory resources have broadly improved with the recruitment of officers while data management support system will assist in identifying suspicious transactions.
Exchange rate policy and external policy buffer	
Maintain the basket exchange rate regime but improve exchange rate management by reviewing the basket's composition on a regular basis.	The currency basket from the exchange rate regime continues to move in a tight band against the U.S. dollar. The weights in the basket have not been recently reviewed. The authorities will review the weights in the currency basket and exchange rate management in early 2022.
Structural Reforms	
Manage the transition from logging to new growth areas. A better business environment would help diversify activity and sustained growth. Strengthening the anti-corruption framework.	The authorities are developing a new mining legislation to guide operation of mining activities, while forestry reform aims to promote re-forestry and downstream processing. Consultations were held with the landowners for the Bina Harbour Tuna Processing Plant project. On narrowing infrastructure gaps: work on the Tina River Hydropower Project has started. The Covid-19 pandemic delayed progress on structural reforms.



SOLOMON ISLANDS

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

December 14, 2021

Prepared By

Asia and Pacific Department (in consultation with other
departments)

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FUND RELATIONS

(As of October 31, 2021)

Membership Status: Joined September 22, 1978; Article VIII

General Resources Account:

	SDR Million	Percent of Quota
Quota	20.80	100.00
Fund holdings of currency	31.52	151.55
Reserve position in the Fund	3.15	15.14

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	29.84	100.00
Holdings	20.79	69.68

Outstanding Purchases and Loans:

	SDR Million	Percent of Quota
RCF Loans	6.93	33.32
Emergency Assistance ^{1/}	13.87	66.68
ECF Arrangements	0.59	2.86

^{1/} Emergency assistance may include ENDA, EPCA, and RFI.

Latest Financial Commitments:

Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF	12/7/2012	3/31/2016	1.04	1.04
SCF	12/6/2011	12/5/2012	5.20	0.00
SCF	6/2/2010	12/1/2011	12.48	12.48

Outright Loans:

Type	Date of Commitment	Date Drawn	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
RFI	6/1/2020	6/3/2020	13.87	13.87
RCF	6/1/2020	6/3/2020	6.93	6.93

^{1/} Undrawn outright disbursements (RFI and RCF) expire automatically 60 days following the date of commitment, i.e., Board approval date.

Projected Payments to Fund:^{1/}**(SDR Million; based on existing use of resources and present holdings of SDRs):**

	Forthcoming				
	2021	2022	2023	2024	2025
Principal		0.19	3.63	7.07	4.23
Charges/Interest	0.04	0.15	0.15	0.09	0.02
Total	0.04	0.34	3.78	7.16	4.26

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

Implementation of HIPC Initiative: Not applicable.**Implementation of MDRI Assistance:** Not applicable.**Implementation of CCR:**

Date of Catastrophe	Board Decision Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
N/A	4/13/2020	0.06	0.06
N/A	10/2/2020	0.07	0.07
N/A	4/1/2021	0.10	0.10
N/A	10/6/2021	0.06	0.06
As of February 4, 2015, the Post-Catastrophe Debt Relief Trust has been transformed to the Catastrophe Containment and Relief (CCR) Trust.			

Exchange Rate Arrangements:

The de jure exchange rate arrangement is a conventional peg arrangement. The Solomon Islands dollar (SBD) is pegged to an invoice-based weighted basket of currencies consisting of the US dollar (USD) (with the weight of 58 percent), the Australian dollar (AUD) (32 percent), the New Zealand dollar (5 percent), the Japanese yen (3 percent), and the British pound (2 percent). The basket weight index is allowed to move and fluctuate along the market movement with no fixed band imposed on the basket movement. The exchange rate is allowed to move along the exchange rate basket and market fundamentals. The Central Bank of Solomon Islands (CBSI) sets the exchange rate vis-à-vis the US dollar in such a way as to maintain the value of the basket constant in SBDs given the movements of currencies in the basket relative to each other. Commercial banks may affect payments without CBSI approval up to specified limits for personal and travel remittances and for

trade and services payments. Payments for current transactions above specified limits require CBSI approval. All capital and financial repayments require CBSI assessment and approval. Commercial banks can exchange SBD against other currencies and are free to set the bid-ask spread for all currencies, except USD and AUD on which there is a spread limit of ± 20 and ± 25 basis points (bps), respectively. In addition, CBSI maintains a standing facility through which it will buy and sell foreign exchange with commercial banks and the government at spot offer and sell rates. The *de facto* classification is “other managed arrangement,” from October 11th, 2019, until June 8th, 2020, and “crawl-like” since then. Solomon Islands has accepted the obligations of Article VIII and maintains an exchange system that is free of restrictions on making of payments and transfers for current international transactions and multiple currency practices.

Last Article IV Consultation: The 2019 Article IV Consultation discussions were held in Honiara during October 30–November 11, 2019. The staff report (IMF Country Report No. 20/49) was considered by the Executive Board and the consultation concluded on February 5, 2020.

Technical Assistance:

Experts from PFTAC and HQ provided support for capacity development in areas of revenue administration, minerals pricing and associated revenue risks, public financial management, macroeconomic frameworks, banking regulation and supervision, AML/CFT, and statistics (national accounts and government financial accounts).

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

RELATIONS WITH OTHER IFIS

Relations with other IFIS:

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

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance	
General: Data provision has some shortcomings but is broadly adequate for surveillance.	
National Accounts: Pacific Financial Technical Assistance Center (PFTAC) has provided technical assistance to compile the 2018-2019 GDP estimates using 2012 as base year. The 2018-2019 GDP estimates have not been published yet.	
Price statistics: A monthly consumer price index (CPI) covering the provincial urban centers of Honiara, Auki, Noro and Gizo is released within two months of the reference period. The weights are based on the 2012/13 Household Income and Expenditure Survey (HIES) and should be updated with the results of the new HIES that was recently initiated.	
Government finance statistics: Monthly fiscal data for the central government are published by the Ministry of Finance and Treasury (MOFT), according to the national presentation. The authorities also collect disbursement information on donors' grants, including those unappropriated in the budget, however the CBSI data collected by the BOP unit and that of the MOFT does not reconcile. Monthly public sector debt data are published, and the quality of debt data has improved through better coordination between the MOFT and the Central Bank of Solomon Islands (CBSI). Public sector debt statistics for the central government are submitted to the World Bank debt database, quarterly and annually. The MOFT does not report revenue, expenditure, balance and composition of financing for the general government because it currently does not have the capacity to compile such statistics, however the CBSI publish data quarterly and annually through the CBSI bulletins in line with the <i>GFSM 2014</i> . PFTAC is working with the authorities to improve the quality of statistics, including expanding institutional coverage.	
Monetary and financial statistics: The CBSI publishes monthly monetary and financial statistics (MFS) in summary form and reports data for the central bank, other depository corporations and other financial corporations to the IMF's Statistics Department using the standardized report forms (SRFs). An integrated monetary database meeting the monetary data needs of the CBSI, APD and STA is in operation. The CBSI reports data on several series indicators of the Financial Access Survey (FAS) including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).	
Financial Soundness Indicators: Financial soundness indicators are reported quarterly to STA.	
External Sector Statistics: The CBSI has been compiling quarterly balance of payment and international investment position (IIP) statistics by using data sources such as the Foreign Exchange Transaction System (FET) and different surveys. Coordinated Direct Investment Data (CDIS) have been compiled since 2014 and reported to IMF Statistics Department for publication. Quarterly gross external debt position public sector debt, publicly guaranteed private sector debt, and private sector debt not publicly guaranteed data are compiled and disseminated through the World Bank Quarterly External Debt Statistics database. Solomon Islands has been one of the beneficiaries of Japan Administered Account Project on the improvement of external sector statistics. Several technical assistance (TA) missions have been conducted under this project. The last one was conducted in April 2018. CBSI staff have also attended several external sector statistics trainings. External sector statistics are in line with the latest methodology (<i>BPM6</i>) with further progress needed in the scope and classifications of some statistics.	
II. Data Standards and Quality	
Solomon Islands is a participant of the Enhanced General Data Dissemination System (e-GDDS) but the implementation is yet to start (i.e., it does not publish yet data under the e-GDDS framework, only metadata).	No data ROSC is available.

Solomon Islands: Table of Common Indicators Required for Surveillance (As of November 2021)					
	Date of latest observation	Date received	Frequency of Data 7/	Frequency of Reporting 7/	Frequency of Publication 7/
Exchange Rates	Nov-21	Nov-21	D	W	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities 1/	Sep-21	Oct-21	M	M	M
Reserve/Base Money	Sep-21	Oct-21	Q	Q	Q
Broad Money	Sep-21	Oct-21	M	M	M
Central Bank Balance Sheet	Sep-21	Oct-21	M	M	M
Consolidated Balance Sheet of the Banking System	Sep-21	Nov-21	M	M	M
Interest Rates 2/	Apr-21	May-21	M	M	M
Consumer Price Index	Sep-21	Nov-21	M	M	M
Revenue, Expenditure, Balance and Composition of Financing 3/ – General Government 4/	NA	NA	NA	NA	NA
Revenue, Expenditure, Balance and Composition of Financing 3/– Central Government	Sep-21	Oct-21	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt 5/	Sep-21	Oct-21	M	M	M
External Current Account Balance	Jun-21	Sep-21	Q	Q	Q
Exports and Imports of Goods and Services	Jun-21	Sep-21	Q	Q	Q
GDP/GNP	2019	Jan-2021	A	A	A
Gross External Debt	Jun-21	Sep-21	Q	Q	Q
International Investment Position 6/	Jun-21	Sep-21	Q	Q	Q
1/ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions. 2/ Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds. 3/ Foreign, domestic bank, and domestic nonbank financing. 4/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments. 5/ Including currency and maturity composition. 6/ Includes external gross financial asset and liability positions vis-à-vis nonresidents. 7/ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); and not available (NA).					



SOLOMON ISLANDS

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION— DEBT SUSTAINABILITY ANALYSIS

December 14, 2021

Approved By

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Marcello Estevão and
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Prepared by the staff of the International Monetary Fund (IMF) and the International Development Association (IDA)

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

External and overall public debt have increased as a result of the COVID-19 pandemic, but Solomon Islands remains at moderate risk of external and overall debt distress.¹ All external debt indicators remain below the relevant indicative thresholds under the baseline scenario but the PV of external debt-to-exports ratio breaches its threshold under an export shock scenario. The PV of public debt-to-GDP ratio remains below the indicative threshold under the baseline scenario but breaches the threshold under the commodity price and real GDP growth shock scenarios. A tailored natural disaster shock of similar scale to the largest historical shock would also cause a significant deterioration in the debt trajectory. While the Debt Sustainability Analysis (DSA) suggests that there is substantial space to absorb shocks, public debt is projected to increase significantly and growth is expected to remain subdued over the medium-term. Solomon Islands also faces significant fiscal liquidity challenges stemming from the current low level of the government cash balance. The debt is vulnerable to export shocks, calling for the need to broaden the export base. With pronounced uncertainty around the economic outlook, debt sustainability needs to be anchored by a prudent fiscal policy to rebuild fiscal buffers, while creating fiscal space for meeting development spending needs through stronger revenue mobilization measures and expenditure rationalization.

¹ Solomon Islands' Composite Indicator (CI) index, calculated based on the October 2021 World Economic Outlook (WEO) and the 2020 Country Policy and Institutional Assessment (CPIA), is 2.651, indicating that the debt-carrying capacity is assessed to be weak.

PUBLIC DEBT COVERAGE

1. The coverage of public sector debt used in this report is central government debt, central government-guaranteed debt, and central bank debt, which is borrowed on behalf of the government. As of end-August 2021, no central government-guaranteed debt had been recorded, and the outstanding debts to the IMF stood at SDR21.45 million (US\$30.6 million; 1.9 percent of GDP). The Ministry of Finance and Treasury's State-Owned Enterprise (SOE) Unit monitors SOE performance and collects basic financial statistics which suggests no outstanding SOE debt. Due to the lack of concrete information, subnational debt and non-guaranteed SOE debt are not included in the analysis.

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

BACKGROUND ON DEBT

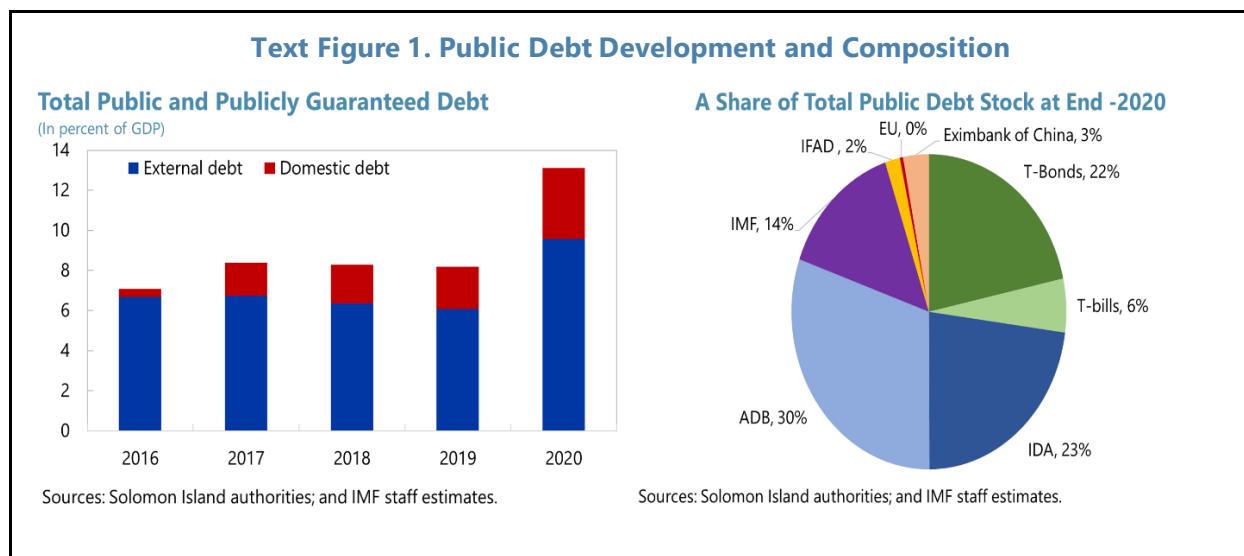
2. Public and Publicly Guaranteed (PPG) external debt stood at US\$150.9 million (9.6 percent of GDP) as of end-2020, an increase of 3.5 percent of GDP from 2019 (Table 1). The Asian Development Bank (ADB) and the International Development Association (IDA) are the largest creditors, accounting for about 92 percent of total external debt. In 2020, an increase in external debt was mainly due to the IMF Rapid Credit Facility/Rapid Financing Instrument (RCF/RFI) (US\$28.84 million, 1.8 percent of GDP), while new external borrowing from the IDA and the ADB also contributed to the large increase in public external debt.

3. Public debt was 13.1 percent of GDP as of end-2020, an increase of 4.9 percent of GDP from 2019 (Table 2).² Public domestic debt increased to SI\$451.6 million (3.5 percent of GDP) at end-2020. Negative real GDP growth and an increase in primary expenditure after the COVID-19 pandemic accounted for the pick-up in debt. The government issued SI\$180 million domestic development bonds to finance the COVID-19 response in 2020, purchased by the Solomon Islands National Provident Fund (NPF), Solomon Power, and the Port Authority.³ Domestic payment arrears

² Solomon Islands has not participated in the G20 Debt Service Suspension Initiative (DSSI).

³ Since 2017, the government has started issuing Development Bonds under negotiated private placements with SOEs and the NPF. Recently, they have had a 10-year maturity (three-year grace period) and 5 percent coupon.

(estimated at SI\$100 million, 0.8 percent of GDP) reportedly re-emerged at the end of 2020, reflecting Public Financial Management weaknesses and increased liquidity pressures.⁴



4. Both public domestic and external borrowings are expected to grow in 2021. New domestic and external borrowing is projected to be around SI\$625 million in 2021. Government has issued four development bonds (SI\$120 million with NPF, SI\$50 million with Pan Oceanic Bank, and SI\$120 million with Solomon Power and Port Authority). Public debt is projected to increase to 16.2 percent of GDP in 2021. The government currently sets a limit for the public debt-to-GDP ratio at 35 percent in nominal terms and, in the 2021 budget, has set an annual borrowing limit at SI\$350 million. There are no explicit and implicit contingent liabilities from state-owned enterprises.⁵ The government plans to provide 50 percent guarantee to Solomon Power's loan to the electricity transmission line for the Tina hydro project (US\$10.6 million) in 2022.

BACKGROUND ON MACRO FORECASTS AND REALISM TOOLS

5. The assumptions in the baseline scenario are consistent with macroeconomic framework. The discount rate used to calculate the net present value of external debt remains at 5 percent. The main assumptions are:

- Following a fall in real GDP in 2020 by 4.3 percent, **real GDP growth** is expected to remain subdued at 0.4 percent in 2021. The relatively slow vaccine rollout and pandemic-related uncertainties

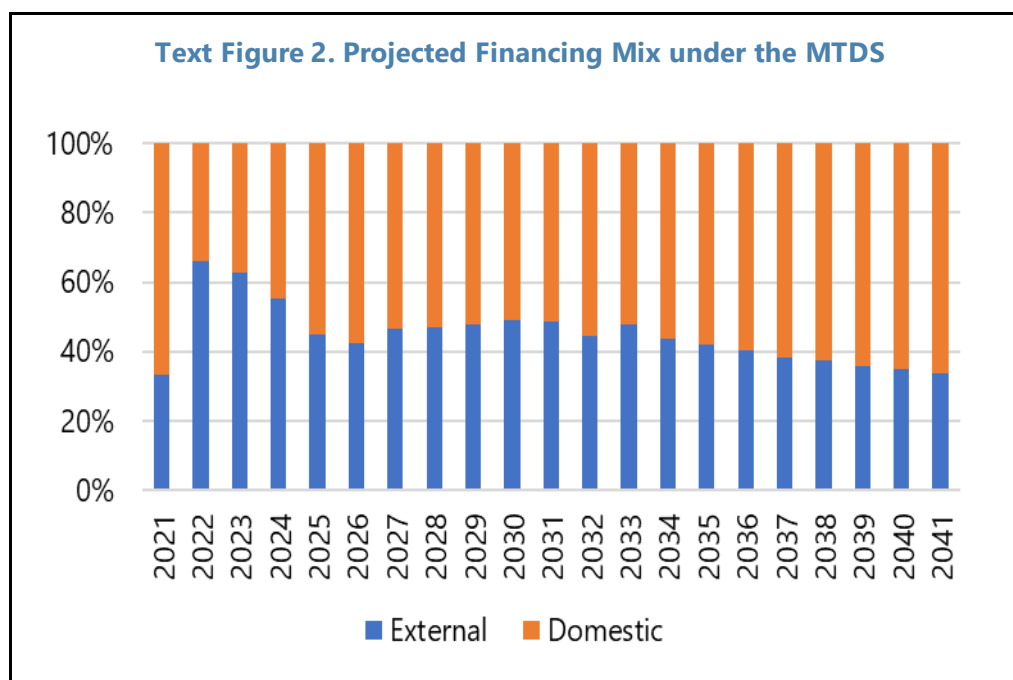
⁴ The payment arrears fall under the *de minimis* case (less than 1 percent of GDP) which does not trigger an "in debt distress" assessment.

⁵ Solomon Airlines received government guarantee related to the purchase of the new aircraft in 2018, which they borrowed from the Bank South Pacific. However, the guarantee was cleared in 2019.

are expected to delay full border reopening and international travel and therefore slow down the recovery in the near term. As borders reopen, growth is projected to pick up, driven by a pipeline of infrastructure projects, including for the 2023 Pacific Games and other priority projects as envisaged in the National Infrastructure Investment Plan (NIIP), as well as investments in other resource sectors. Despite this, the medium-term, growth outlook remains subdued, averaging at 2.8 percent over 2021–31, reflecting inter alia decline in traditional growth drivers (logging) and high vulnerability to the natural disasters.

- **Inflation** (measured by the GDP deflator) is projected to increase, also reflecting the impact of higher global commodity prices, and average 4.1 percent during 2021–31.
- **The non-interest current account deficit** is projected to remain large at 9.8 percent of GDP on average over 2021–31, driven by high import growth related to expected infrastructure investments and a projected trend decline in logging exports. Agricultural exports have remained weak due to climate-related shocks. Over the medium-term, official grants are projected to decline and average 1.6 percent of GDP, while FDI inflow will remain around 2.6 percent of GDP.
- **Fiscal outlook:** A fall in revenue and a COVID-related increase in spending has widened the primary deficit from 0.5 percent of GDP in 2019 to 2.2 percent of GDP in 2020, financed by grants, concessional loans, and the issuance of domestic development bonds. Going forward, fiscal deficits are expected to persist, driven by continued weak revenue trends, including from decline in revenue from logging and other international trade taxes, and large development spending needs to achieve SDGs and climate adaptation goals. The primary deficit is projected to remain elevated at a ten-year average of 3.3 percent of GDP.
- **Fiscal policy aims to support growth through increased public investment:** Solomon Islands is a lower-middle income country faced with a lack of quality infrastructure. However, a large public investment program in roads, air transport, telecommunications, sporting facilities and energy sectors is anticipated to drive growth. The overall goal of the investment program – which is largely donor-funded – aims to improve connectivity and sustainable energy provision. Increased connectivity and transport facilities may crowd in private investment. Uncertainties remain, however, regarding implementation capacity and COVID-related travel restrictions. Furthermore, the implementation of the infrastructure pipeline is expected to significantly increase public debt, pointing to the need to boost medium-term potential growth and prioritizing investment projects that build resilience to natural disasters.
- **External and domestic financing:** New external loan disbursements to finance large infrastructure are expected to increase to about 3 percent of GDP over the next three years, supported by multilateral institutions (e.g., World Bank and ADB) and bilateral donors (e.g., JICA, Australia, and New Zealand). From 2026 onwards, the level of new net external borrowing is expected to remain around 2.2 percent of GDP. The majority of external financing is assumed to be concessional with the average grant element of new borrowing around 45 percent. The government is expected to be committed to its annual T-bill issuance limit of SI\$100million, while

gradually increasing development bonds issuance in line with the Medium-Term Debt Management Strategy (MTDS). As a result, the public debt profile would shift gradually toward domestic financing. The share of domestic financing is temporarily elevated at 67 percent in 2021 owing to the issuance of domestic development bonds (SI\$290 million) and slow implementation of donor-funded projects due to the border closure. The redemption profile of domestic debt reflects the rollover of T-bills every year and an updated amortization schedule of development bonds, which peaks in 2032 when the 15-year development bond (SI\$120 million, issued in 2017) matures.



6. The major difference of assumptions between the previous DSA and the current DSA relate to weaker economic performance due to the pandemic in 2020 and 2021. The current DSA assumes; lower growth rates and fiscal revenue collection than the previous projection, reflecting subdued production, border closure and pandemic-related uncertainties; lower primary expenditure, reflecting under-execution of capital expenditure; lower exports, reflecting weaker than expected agricultural exports and a decline in logging export; and lower imports due to weaker construction and domestic demand.

Text Table 1. DSA Key Macroeconomic Assumptions

	Previous DSA		Current DSA		Current vs. Previous	
	2021-26	2021-31	2021-26	2021-31	2021-26	2021-31
Real GDP growth, percent	3.6	3.4	2.5	2.8	-1.1	-0.7
Inflation (GDP deflator), percent	3.2	3.3	4.3	4.1	1.0	0.8
(In percent of GDP)						
Revenue and grants	32.5	31.7	29.8	29.3	-2.8	-2.4
Primary expenditure	36.4	35.2	32.9	32.6	-3.4	-2.5
Primary balance	-3.8	-3.5	-3.1	-3.3	0.7	0.1
Exports of goods and services	36.0	35.1	25.6	23.3	-10.4	-11.8
Imports of goods and services	48.3	46.3	40.1	37.9	-8.2	-8.4
Non-interest current account balance	-11.1	-9.6	-9.5	-9.8	1.6	-0.2

7. The realism tools suggest that the macroeconomic and fiscal assumptions are reasonable. The external and public PPG debt trajectory in the current DSA locates slightly below the previous DSA (Figure 3), reflecting the difference in initial debt level. The projected fiscal adjustment lies towards the bottom part of the distribution of LIC's past adjustment episodes, reflecting the projected increase in development spending (Figure 4, left). Staff's real GDP growth projection during 2021–23 is higher than the growth path projected by the realism tool based on the assumed fiscal multiplier (Figure 4, right). The difference is mainly explained by the significant rebound in growth after the deep COVID-19 recession, reflecting a resumption of economic activities and recovery in global demand. The low elasticity of growth to fiscal impulse for 2021–23 indicates a limited fiscal multiplier effect.

COUNTRY CLASSIFICATION AND DETERMINATION OF SCENARIO STRESS TEST⁶

8. Solomon Islands' debt-carrying capacity is weak. The Composite Indicator (CI) index is 2.651, indicating that the debt-carrying capacity is assessed to be weak in the LIC-DSA framework. The CI score is based on the October 2021 World Economic Outlook (WEO) and 2020 World Bank's CPIA. The classification was downgraded from "moderate" in the 2019 DSA to "weak" based on data in the April and October 2021 WEOs and 2020 CPIA.

9. Based on the CI rating, Solomon Islands' debt is assessed against the following thresholds. The relevant indicative thresholds for the category are 35 percent for the PV of debt-to-GDP ratio, 30 percent for the PV of PPG external debt-to-GDP ratio, 140 percent for the PV of PPG

⁶ Six standardized stress tests in the DSF are applied to both external and public DSA. They capture shocks to real GDP growth, the primary fiscal balance, exports, other flows (including official and private transfers and FDI), exchange rate depreciation, and a combination of these shocks.

external debt-to-exports ratio, 10 percent for the PPG external debt service-to-exports ratio, and 14 percent for the PPG external debt service-to-revenue ratio.

Text Table 2. Solomon Islands: Composite Indicator Score and Rating

Country	Solomon Islands
Country Code	813

Debt Carrying Capacity	Weak
-------------------------------	-------------

Final	Classification based on current vintage	Classification based on the previous vintage	Classification based on the two previous vintage
Weak	Weak 2.651	Weak 2.645	Weak 2.681

Applicable thresholds

APPLICABLE	
EXTERNAL debt burden thresholds	
PV of debt in % of	
Exports	140
GDP	30
Debt service in % of	
Exports	10
Revenue	14

APPLICABLE	
TOTAL public debt benchmark	
PV of total public debt in percent of GDP	35

10. Tailored stress tests on natural disasters and volatile commodity prices are applied:

- *Commodity price shock*: the scenario considers a sudden one standard deviation decline in fuel and non-fuel prices, associated with reductions in real GDP growth and revenues, which are assumed to gradually recover over six years.
- *Natural disaster shock*: Solomon Islands, which is defined as small developing natural disaster-prone state, is automatically subject to the standard natural disaster shock.⁷ The default parameter setting of this shock was modified to reflect Solomon Islands-specific factors based on the findings of staff's research on the impact of natural disasters.⁸ The study is based on EM-

⁷ The IMF board paper, "Small States' Resilience to Natural Disasters and Climate Change – Role for the IMF", 2016.

⁸ Please see the details in the IMF Working paper 18/108, "The Economic Impact of Natural Disaster in Pacific Island Countries."

DAT, an international disaster database, which shows that historically the largest damage from natural disasters in Pacific Island countries during 1980–2016 was estimated at 14 percent of GDP. Based on this analysis, the natural disaster shock was adjusted to a 14 percent of GDP shock to GDP, associated with reductions in real GDP growth and exports by 2.67 and 8.12 percentage points, respectively.

11. A stress test for the combined contingent liability shock uses the default setting for implicit SOE and financial market debt. The stress test incorporates implicit contingent liabilities amounting to 7 percent of GDP, which comprises 2 percent of GDP of non-guaranteed SOE debt and 5 percent of potential liabilities stemming from the financial market.

Text Table 3. Contingent Liability Stress Test

1 The country's coverage of public debt		The central government, central bank, government-guaranteed debt		
		Default	Used for the analysis	Reasons for deviations from the default settings
2 Other elements of the general government not captured in 1.		0 percent of GDP	0	PPP capital stock data is not available.
3 SoE's debt (guaranteed and not guaranteed by the government) 1/		2 percent of GDP	2	
4 PPP		35 percent of PPP stock	0	
5 Financial market (the default value of 5 percent of GDP is the minimum value)		5 percent of GDP	5	
Total (2+3+4+5) (in percent of GDP)			7.0	

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition.

DEBT SUSTAINABILITY

A. External Debt Sustainability Analysis

12. Under the baseline scenario, all external PPG debt indicators remain below the policy relevant thresholds for the next ten years (Table 1, Figure 1a).⁹ The PV of PPG external debt-to-GDP ratio is expected to grow gradually from 7 percent in 2020 to 13.8 percent in 2031 due mainly to new disbursements for key infrastructure projects (Table 3). As Figure 3 shows, the main driver of debt dynamics is a deterioration of the current account balance. PPG external debt service indicators are projected to moderately rise in the near-term when the repayment of IMF emergency financing is due.

13. The standardized stress test shows that an export shock has the largest negative impact on the external debt trajectory.¹⁰ The PV of PPG external debt-to-export ratio is expected to breach the indicative threshold under the export shock scenario (Table 3). High sensitivity of external debt sustainability to export shock suggests the need to expand the export base, as logging activity is expected to substantially decline in the medium term. Adding local value in agriculture

⁹ Relatively large residuals in external financing mainly reflect a drawdown of reserves, caused by financing from the capital and financial accounts falling short of the current account deficit.

¹⁰ The export shock sets nominal export growth (in USD) to its historical average minus one standard deviation (SD), or the baseline projection minus one SD, whichever is lower in the second and third years of the projection period.

and investments in fisheries and mining could support the potential growth in exports. The “other flows” shock also causes a significant increase in the PV of debt-to-GDP ratio, suggesting that Solomon Islands is also vulnerable to changes in donors’ external loans. Other shocks, including to real GDP growth, primary balance, and one-time 30 percent depreciation, do not lead to a breach of any debt thresholds. Net debt creating flow is negative under the historical scenario, reflecting smaller current account deficit and larger official grants in the last ten years on average.

14. A tailored natural disaster shock causes all the debt trajectories for each debt indicator to move upward. Though the DSA assumes a one-off shock that takes place in 2022, there is a possibility that multiple severe natural disasters could occur within a 10-year timeframe. Staff’s work shows that there is a probability of around 13.5 percent of a disaster each year of a magnitude of more than 3 percent of GDP or impacting 5 percent of the population. Multiple natural disasters would have a larger cumulative effect on debt sustainability through lower long-term growth and higher borrowing needs for post-disaster reconstruction efforts.

B. Public Sector Debt Sustainability Analysis

15. Under the baseline scenario, the PV of public debt-to-GDP ratio does not breach the 35 percent benchmark (Table 2, Figure 2). However, the nominal public debt-to-GDP ratio is projected to reach the authorities’ policy threshold of 35 percent in nominal terms by 2029.¹¹ As Figure 3 indicates, the increase is mainly driven by a high primary deficit. The public debt service-to-revenue ratio is projected to moderately rise over the medium term.

16. The sensitivity analysis shows that a shock to commodity prices leads to the largest increase in debt by 2031 (Figure 2, Table 4). The PV of debt-to-GDP ratio would breach the indicative threshold by 2026 due to commodity price shock. As a small exporter, Solomon Islands is highly exposed to international price fluctuations and Chinese market demand for logs. Public debt sustainability is also sensitive to a slowdown in real GDP growth. The country’s high vulnerability to shocks in commodity prices and real GDP growth highlights the urgency of economic diversification and finding new growth drivers. Fisheries and mining have potential as future growth drivers but require additional investment in infrastructure and production facilities. Shocks in commodity prices and real GDP growth have durable impacts on public debt service. Like external DSA, net debt creating flow is negative under the historical scenario, reflecting a primary surplus in the last ten years on average.

17. Tailored natural disaster and combined contingent liability shocks result in a deterioration in debt sustainability. In the natural disaster shock scenario, the debt service-to-revenue ratio is expected to significantly increase compared to the baseline one year after the shock and the PV of public debt-to-GDP ratio would breach the threshold of 35 percent by 2027. In the combined contingent liability shock scenario, the trajectory of the PV of public debt-to-GDP ratio

¹¹ The debt target and annual borrowing limit are indicative and have been adjusted to increase development spending. Operationalizing the fiscal anchor will require an appropriate operational target and strengthening PFM.

moves upwards by 4-6 percentage points from the baseline. These results highlight the importance of rebuilding fiscal buffers against external shocks, including natural disasters, and contingent liability shocks.

RISK RATING AND VULNERABILITIES

18. The DSA analysis suggests that Solomon Islands' risk of external debt distress is moderate. All external debt indicators remain below the relevant indicative thresholds under the baseline scenario. However, public debt is projected to increase significantly while growth is expected to remain subdued over the medium-term. An export shock scenario would result in a significant deterioration in external debt sustainability. Even though debt service indicators are below their thresholds in most cases, maximizing concessional loans would help keep the debt burden contained. Figure 5 suggests that there is substantial space to absorb shocks, reflecting a current low level of external debt.¹² However, the pandemic related deterioration in the fiscal position, as reflected in the decline in government cash balance, as well as constraints to absorptive capacity call for caution in debt accumulation.¹³ With pronounced uncertainty around the economic outlook, debt sustainability needs to be anchored by a prudent fiscal policy to rebuild fiscal buffers, while creating fiscal space for meeting development spending needs through stronger revenue mobilization measures and expenditure rationalization.

19. The DSA suggests that overall risk of debt distress is moderate with substantial space to absorb shocks. However, given the projected widening of fiscal deficits, the scenarios involving shocks to commodity prices and real GDP growth would significantly worsen public debt sustainability. Both the tailored natural disaster and combined contingent liability shocks would also deteriorate debt sustainability significantly. These vulnerabilities call for measures to rebuild fiscal buffers, broaden the export base, boost medium-term potential growth and prioritizing investment projects that build resilience to natural disasters.

20. The public debt portfolio faces limited refinancing and interest rate risks.¹⁴ About 70 percent of public debt is external loans that are contracted at highly concessional terms.¹⁵ There is rollover risk associated with T-bills (which account for about 17 percent of domestic debt) but the risk is limited given excess market liquidity and high market demand for government securities. Given high liquidity in the banking system, yields of government securities have remained broadly constant over the past years. This is the case for both T-bill auctions (e.g. yields for one-year T-bills

¹² The space is measured by the distance between the baseline debt burden indicators and their thresholds.

¹³ With the Sustainable Development Financing Policy, the IDA has been promoting sustainable borrowing and lending practices in Solomon Islands, with policy and performance actions supporting debt management, debt transparency and fiscal sustainability.

¹⁴ More details are presented in the authority's Medium Term Debt Management Strategy 2021–2024.

¹⁵ The Average Time To Maturity (ATM) for external (domestic) debt is 13.6 (6.2) years. The weighted average interest rate is 1 percent for external loans and borrowing costs for domestic debt is relatively low and stable at 4.9 percent.

have amounted to around 1.9 percent) and the negotiated coupon rate on the development bonds, thereby limiting interest rate risk.

AUTHORITIES' VIEWS

21. Authorities broadly agreed with staff's analysis of Solomon Islands' debt sustainability. They underscored their firm commitment to the Medium-Term Debt Strategy, including increasing the share of financing from the domestic debt market. Authorities stressed their intention to manage debt within the 35 percent of GDP threshold in the medium-term and appreciated the staff's analysis of the fiscal anchor. Authorities aim to gradually rebuild fiscal buffers by increasing transfers to the debt service account to meet domestic payment obligations. While agreeing that there is room for additional spending in the near term to accelerate the economic recovery, authorities broadly agreed with the need for revenue and expenditure measures to lower fiscal deficits looking forward.

Table 1. Solomon Islands: External Debt Sustainability Framework, Baseline Scenario, 2018–41

(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/ Historical Projections	
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2031	2041	Historical	Projections
External debt (nominal) 1/ of which: public and publicly guaranteed (PPG)	7.1 6.3	7.0 6.1	10.6 9.6	11.7 10.7	13.6 12.4	15.4 14.2	16.8 15.5	17.8 16.5	18.8 17.5	23.6 22.1	27.2 25.4	11.6 8.6	18.5 17.2
Change in external debt	-0.3	-0.2	3.6	1.2	1.8	1.9	1.3	1.0	1.0	0.8	0.0		
Identified net debt-creating flows	1.6	8.0	1.4	3.7	9.3	8.8	6.7	6.0	6.5	7.5	8.6	-0.2	7.0
Non-interest current account deficit	3.0	9.7	1.5	5.0	12.2	12.0	9.6	8.8	9.3	10.5	11.4	3.5	9.8
Deficit in balance of goods and services	4.3	10.3	8.2	11.2	17.5	16.7	14.3	13.4	13.7	15.4	16.7	6.9	14.6
Exports	43.2	37.7	27.7	24.5	26.2	28.2	26.3	24.8	23.6	18.8	13.3		
Imports	47.5	48.0	36.0	35.7	43.7	44.9	40.5	38.2	37.3	34.2	30.0		
Net current transfers (negative = inflow)	-2.6	-1.5	-4.3	-4.7	-4.0	-3.5	-3.6	-3.5	-3.6	-3.8	-4.2	-6.7	-3.7
of which: official	-3.7	-3.7	-4.7	-4.7	-3.6	-3.1	-2.5	-2.1	-2.1	-1.7	-1.6		
Other current account flows (negative = net inflow)	1.2	0.9	-2.4	-1.5	-1.3	-1.1	-1.0	-1.1	-0.8	-1.1	-1.1	3.3	-1.1
Net FDI (negative = inflow)	-1.0	-1.8	-0.4	-1.5	-2.8	-3.1	-2.8	-2.6	-2.6	-2.6	-2.3	-2.9	-2.6
Endogenous debt dynamics 2/	-0.3	0.1	0.2	0.1	0.0	-0.2	-0.2	-0.2	-0.2	-0.3	-0.5		
Contribution from nominal interest rate	0.1	0.1	0.1	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.4		
Contribution from real GDP growth	-0.3	-0.1	0.3	0.0	-0.3	-0.4	-0.4	-0.5	-0.5	-0.7	-0.8		
Contribution from price and exchange rate changes	-0.2	0.1	-0.2	...	...	...	...	...	...	...	...
Residual 3/	-1.9	-8.2	2.2	-2.5	-7.5	-6.9	-5.4	-5.0	-5.4	-6.7	-8.6	-1.4	-5.8
of which: exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	...	...	7.1	7.7	8.2	9.0	9.4	9.7	10.2	13.8	16.6		
PV of PPG external debt-to-exports ratio	...	...	25.5	31.5	31.4	31.8	35.7	39.1	43.4	73.2	125.1		
PPG debt service-to-exports ratio	1.1	1.4	1.5	1.8	1.8	2.5	3.5	3.0	2.1	2.9	7.5		
PPG debt service-to-revenue ratio	1.6	2.0	1.7	2.0	2.1	2.9	3.7	3.0	2.1	2.4	4.5		
Gross external financing need (Million of U.S. dollars)	39.3	132.8	25.3	66.2	174.6	185.3	160.5	154.4	171.2	281.4	681.2		
Key macroeconomic assumptions													
Real GDP growth (in percent)	3.9	1.2	-4.3	0.4	2.3	3.4	2.9	3.1	3.1	3.1	3.3	2.9	2.8
GDP deflator in US dollar terms (change in percent)	2.1	-1.5	2.9	6.4	4.5	4.1	4.4	4.2	4.1	4.0	4.2	3.4	4.3
Effective interest rate (percent) 4/	1.2	1.5	1.6	1.9	2.0	1.9	1.8	1.8	1.6	1.5	1.5	1.9	1.7
Growth of exports of G&S (US dollar terms, in percent)	13.8	-13.1	-27.5	-5.6	14.5	15.8	0.0	1.3	2.2	2.5	4.5	5.6	3.7
Growth of imports of G&S (US dollar terms, in percent)	10.0	0.6	-26.1	5.9	31.0	10.6	-3.1	1.2	4.9	6.0	6.6	0.8	7.0
Grant element of new public sector borrowing (in percent)	...	...	...	33.7	59.3	48.6	48.6	51.2	47.0	41.2	43.6	...	45.4
Government revenues (excluding grants, in percent of GDP)	30.5	26.4	24.4	22.3	23.0	24.1	24.9	24.6	24.5	23.3	22.0	28.5	23.8
Aid flows (in Million of US dollars) 5/	254.0	194.9	286.7	150.1	153.2	153.4	156.9	162.5	170.2	230.2	456.5		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	9.3	8.3	7.6	7.3	7.1	6.9	6.6	6.3	...	7.3
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	88.4	88.2	82.2	82.5	84.9	84.4	81.7	81.7	...	83.8
Nominal GDP (Million of US dollars)	1,575	1,570	1,546	1,652	1,766	1,902	2,044	2,195	2,355	3,332	6,736		
Nominal dollar GDP growth	6.1	-0.3	-1.5	6.9	6.9	7.7	7.5	7.4	7.3	7.2	7.7	6.5	7.2
Memorandum items:													
PV of external debt 7/	...	...	8.1	8.8	9.4	10.2	10.6	11.0	11.6	15.3	18.4		
In percent of exports	...	...	29.2	36.0	35.8	36.1	40.5	44.4	49.1	81.4	138.3		
Total external debt service-to-exports ratio	1.3	1.6	1.8	2.0	2.0	2.7	3.8	3.2	2.4	3.3	8.1		
PV of PPG external debt (in Million of US dollars)	...	...	109.6	127.6	145.4	170.8	191.8	212.7	241.3	458.7	1118.7		
(PVt-PVt-1)/GDPT-1 (in percent)	...	...	...	1.2	1.1	1.4	1.1	1.0	1.3	1.6	1.3		
Non-interest current account deficit that stabilizes debt ratio	3.3	9.9	-2.1	3.8	10.4	10.2	8.3	7.8	8.3	9.7	11.4		

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

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

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

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

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

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

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

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

Definition of external/domestic debt	Residency-based
Is there a material difference between the two criteria?	Yes

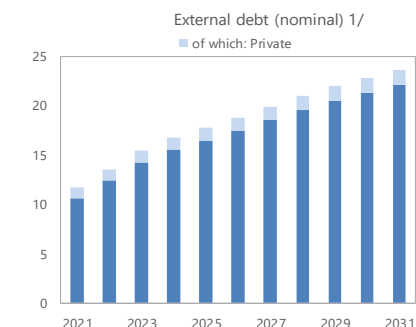
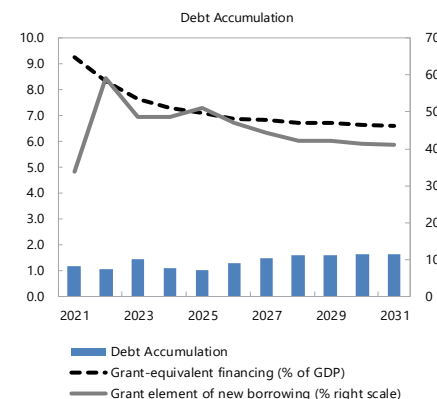


Table 2. Solomon Islands: Public Sector Debt Sustainability Framework, Baseline Scenario, 2018–41

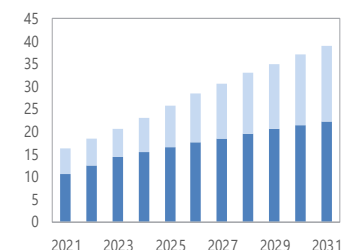
(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2031	2041	Historical	Projections
Public sector debt 1/ of which: external debt	8.3 6.3	8.2 6.1	13.1 9.6	16.2 10.7	18.3 12.4	20.7 14.2	23.1 15.5	25.6 16.5	28.3 17.5	39.0 22.1	64.3 25.4	11.1 8.6	27.9 17.2
Change in public sector debt	-0.1	-0.1	4.9	3.1	2.1	2.4	2.4	2.5	2.7	2.1	2.7		
Identified debt-creating flows	-1.7	0.4	4.2	2.5	2.4	2.8	2.6	3.0	3.0	2.6	3.5	-1.8	2.7
Primary deficit	-1.4	0.5	2.2	2.6	2.7	3.3	3.1	3.6	3.7	3.5	5.0	-1.1	3.3
Revenue and grants	40.4	32.8	33.2	30.9	29.7	30.1	30.7	30.4	30.2	28.8	27.2	41.0	29.9
of which: grants	9.9	6.4	8.8	8.6	6.7	6.1	5.8	5.8	5.7	5.6	5.2		
Primary (noninterest) expenditure	39.0	33.3	35.5	33.5	32.4	33.4	33.9	33.9	33.9	32.3	32.2	39.8	33.2
Automatic debt dynamics	-0.3	-0.1	0.2	0.0	-0.3	-0.5	-0.5	-0.6	-0.7	-0.9	-1.5		
Contribution from interest rate/growth differential	-0.4	-0.1	0.4	0.0	-0.3	-0.5	-0.5	-0.6	-0.7	-0.9	-1.5		
of which: contribution from average real interest rate	-0.1	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.2	0.5		
of which: contribution from real GDP growth	-0.3	-0.1	0.4	-0.1	-0.4	-0.6	-0.6	-0.7	-0.8	-1.1	-2.0		
Contribution from real exchange rate depreciation	0.1	0.1	-0.2	...	...	...	...	...	...	...	...
Other identified debt-creating flows	0.0	0.0	1.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.0
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (e.g. IMF loan)	0.0	0.0	1.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	1.6	-0.5	0.7	0.6	-0.3	-0.4	-0.2	-0.5	-0.3	-0.5	-0.8	0.8	-0.4
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	...	...	10.5	13.3	14.1	15.5	17.0	18.8	21.1	30.7	55.5		
PV of public debt-to-revenue and grants ratio	...	...	31.6	43.1	47.5	51.3	55.3	62.0	69.8	106.5	203.8		
Debt service-to-revenue and grants ratio 3/	2.1	3.1	3.8	4.2	5.0	6.0	6.7	6.8	6.0	6.1	16.6		
Gross financing need 4/	-0.6	1.5	5.3	3.9	4.2	5.1	5.2	5.6	5.4	5.2	9.5		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	3.9	1.2	-4.3	0.4	2.3	3.4	2.9	3.1	3.1	3.1	3.3	2.9	2.8
Average nominal interest rate on external debt (in percent)	0.7	1.1	1.1	1.5	1.7	1.6	1.5	1.6	1.4	1.3	1.3	1.0	1.4
Average real interest rate on domestic debt (in percent)	-2.6	-1.0	2.1	0.5	1.2	1.6	1.4	1.6	1.6	1.8	1.6	-2.4	1.5
Real exchange rate depreciation (in percent, + indicates depreciation)	2.0	1.1	-3.6	...	...	...	...	...	...	...	...	-1.9	...
Inflation rate (GDP deflator, in percent)	2.9	1.3	3.4	4.2	4.5	4.1	4.4	4.2	4.1	4.0	4.2	3.5	4.1
Growth of real primary spending (deflated by GDP deflator, in percent)	-0.4	-13.7	2.0	-5.1	-0.9	6.7	4.2	3.2	3.1	2.8	3.2	0.1	2.0
Primary deficit that stabilizes the debt-to-GDP ratio 5/	-1.3	0.6	-2.7	-0.6	0.6	0.9	0.7	1.1	1.0	1.4	2.3	-1.2	1.0
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.2		

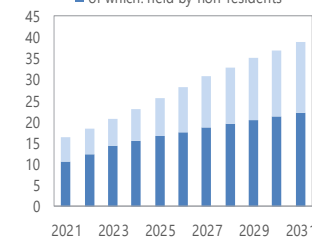
Definition of external/domestic debt	Residency-based
Is there a material difference between the two criteria?	Yes

Public sector debt 1/

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



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



Sources: Country authorities; and staff estimates and projections.

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

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

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

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

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

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

Table 3. Solomon Islands: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2021–31 (In percent)

	Projections 1/										
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
PV of debt-to GDP ratio											
Baseline	7.7	8	9	9	10	10	11	12	12	13	13.8
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	8	3	0	-3	-6	-8	-11	-14	-16	-18	-21
B. Bound Tests											
B1. Real GDP growth	8	9	10	10	11	11	12	13	14	15	15
B2. Primary balance	8	9	11	11	12	12	13	14	15	15	16
B3. Exports	8	13	23	23	23	23	24	24	25	25	25
B4. Other flows 3/	8	12	17	17	18	18	18	19	19	20	20
B5. Depreciation	8	10	7	8	9	9	10	11	12	13	14
B6. Combination of B1-B5	8	14	16	16	17	17	18	18	19	19	20
C. Tailored Tests											
C1. Combined contingent liabilities	8	10	11	12	12	12	13	14	15	15	16
C2. Natural disaster	8	13	14	15	15	16	17	18	19	19	20
C3. Commodity price	8	10	13	13	13	14	14	14	14	14	14
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	30	30	30	30	30	30	30	30	30	30	30
PV of debt-to-exports ratio											
Baseline	32	31	32	36	39	43	49	54	60	67	73
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	32	13	-2	-12	-23	-35	-48	-63	-78	-93	-109
B. Bound Tests											
B1. Real GDP growth	32	31	32	36	39	43	49	54	60	67	73
B2. Primary balance	32	35	39	44	48	52	58	64	70	77	84
B3. Exports	32	70	161	173	183	194	207	221	235	248	257
B4. Other flows 3/	32	48	61	66	71	76	81	88	94	100	105
B5. Depreciation	32	31	21	25	28	32	37	42	48	54	61
B6. Combination of B1-B5	32	63	52	88	94	101	110	119	129	138	146
C. Tailored Tests											
C1. Combined contingent liabilities	32	39	40	44	48	53	58	64	71	77	84
C2. Natural disaster	32	51	52	58	64	70	78	86	94	103	112
C3. Commodity price	32	46	52	56	58	60	63	67	71	75	78
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	140	140	140	140	140	140	140	140	140	140	140

Table 3. Solomon Islands: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2021–31 (In percent) (concluded)

	Projections 1/										
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Debt service-to-exports ratio											
Baseline	2	2	2	4	3	2	2	2	3	3	3
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	2	2	2	3	2	1	1	0	0	-1	-2
B. Bound Tests											
B1. Real GDP growth	2	2	2	4	3	2	2	2	3	3	3
B2. Primary balance	2	2	3	4	3	2	2	2	3	3	4
B3. Exports	2	3	6	9	8	6	7	7	7	10	14
B4. Other flows 3/	2	2	3	4	4	3	3	3	3	4	5
B5. Depreciation	2	2	2	3	3	2	2	2	2	2	2
B6. Combination of B1-B5	2	2	4	6	5	4	4	4	5	6	7
C. Tailored Tests											
C1. Combined contingent liabilities	2	2	3	4	3	2	2	2	3	3	3
C2. Natural disaster	2	2	3	4	4	3	3	3	3	3	4
C3. Commodity price	2	2	3	4	4	3	3	3	3	3	4
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	10	10	10	10	10	10	10	10	10	10	10
Debt service-to-revenue ratio											
Baseline	2	2	3	4	3	2	2	2	2	2	2
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	2	2	3	3	2	1	1	0	0	-1	-2
B. Bound Tests											
B1. Real GDP growth	2	2	3	4	3	2	2	2	2	2	3
B2. Primary balance	2	2	3	4	3	2	2	2	2	3	3
B3. Exports	2	2	4	5	4	3	3	3	3	4	6
B4. Other flows 3/	2	2	3	4	4	3	3	3	3	3	4
B5. Depreciation	2	3	4	4	4	2	2	2	3	3	2
B6. Combination of B1-B5	2	2	4	5	4	3	3	3	3	4	4
C. Tailored Tests											
C1. Combined contingent liabilities	2	2	3	4	3	2	2	2	2	2	3
C2. Natural disaster	2	2	3	4	3	2	2	2	3	3	3
C3. Commodity price	2	2	3	5	4	3	2	2	2	3	3
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	14	14	14	14	14	14	14	14	14	14	14

Sources: Country authorities; and staff estimates and projections.

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

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

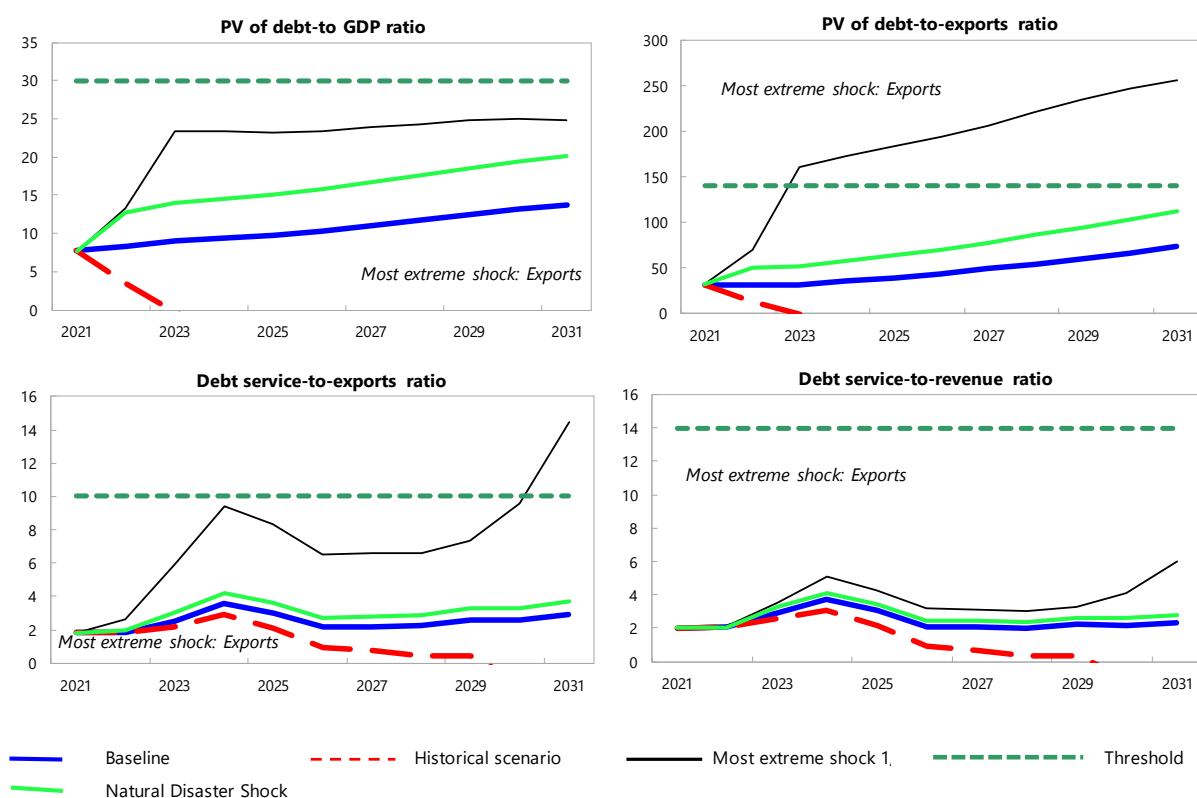
3/ Includes official and private transfers and FDI.

Table 4. Solomon Islands: Sensitivity Analysis for Key Indicators of Public Debt, 2021–31
(In percent)

	Projections 1/										
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
PV of Debt-to-GDP Ratio											
Baseline	13	14	15	17	19	21	23	25	27	29	31
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	13	11	9	8	6	6	4	3	2	1	1
B. Bound Tests											
B1. Real GDP growth	13	16	20	24	28	32	36	40	44	48	51
B2. Primary balance	13	17	20	22	23	26	28	29	31	33	35
B3. Exports	13	19	28	29	31	33	34	36	38	39	40
B4. Other flows 3/	13	18	24	25	27	29	30	32	34	35	37
B5. Depreciation	13	15	14	14	14	15	16	17	18	18	19
B6. Combination of B1-B5	13	15	17	17	19	21	23	25	26	28	30
C. Tailored Tests											
C1. Combined contingent liabilities	13	20	21	22	24	26	28	30	31	33	35
C2. Natural disaster	13	26	27	29	31	33	36	38	40	42	44
C3. Commodity price	13	16	21	27	32	38	42	47	50	54	58
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
TOTAL public debt benchmark	35	35	35	35	35	35	35	35	35	35	35
PV of Debt-to-Revenue Ratio											
Baseline	43	48	51	55	62	70	77	85	92	99	107
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	43	38	31	26	21	18	15	11	8	5	2
B. Bound Tests											
B1. Real GDP growth	43	53	66	76	90	105	119	133	147	161	174
B2. Primary balance	43	56	68	71	77	85	92	100	107	113	121
B3. Exports	43	63	93	95	101	108	115	122	128	134	139
B4. Other flows 3/	43	62	79	82	88	95	102	109	116	122	127
B5. Depreciation	43	50	47	46	48	51	54	58	61	65	69
B6. Combination of B1-B5	43	52	56	55	61	69	76	83	90	97	105
C. Tailored Tests											
C1. Combined contingent liabilities	43	66	68	71	78	85	92	100	107	114	121
C2. Natural disaster	43	86	89	93	101	110	119	127	136	144	152
C3. Commodity price	43	58	75	93	111	128	143	156	170	184	199
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Debt Service-to-Revenue Ratio											
Baseline	4	5	6	7	7	6	6	6	6	6	6
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	4	5	5	5	4	3	2	1	1	1	0
B. Bound Tests											
B1. Real GDP growth	4	5	7	9	9	8	8	9	9	9	10
B2. Primary balance	4	5	7	9	8	7	7	6	7	7	7
B3. Exports	4	5	6	8	8	7	6	6	7	7	9
B4. Other flows 3/	4	5	6	7	7	6	6	6	6	7	8
B5. Depreciation	4	5	6	7	7	6	6	5	6	5	5
B6. Combination of B1-B5	4	5	6	7	7	6	6	6	6	6	6
C. Tailored Tests											
C1. Combined contingent liabilities	4	5	9	8	8	7	6	6	7	7	7
C2. Natural disaster	4	5.1	12.0	9	9	8	8	8	8	8	8
C3. Commodity price	4	5	7	9	10	10	10	10	10	11	11
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: Country authorities; and staff estimates and projections.

Figure 1. Solomon Islands: Indicators of Public and Publicly Guaranteed External Debt under Baseline Scenario, 2021–31 1/



Customization of Default Settings		
	Size	Interactions
Tailored Stress		
Combined CL	No	
Natural disaster	Yes	Yes
Commodity price	No	No
Market financing	n.a.	n.a.

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

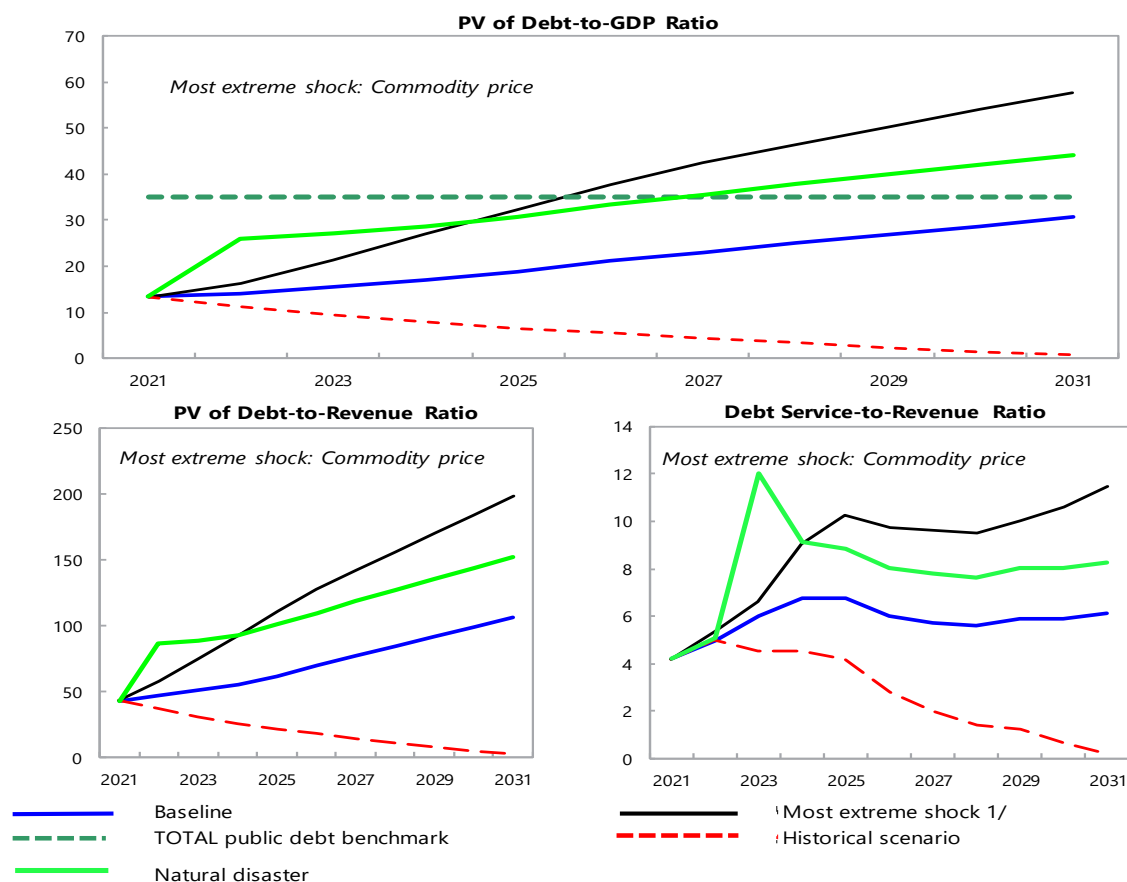
Borrowing assumptions on additional financing needs resulting from the stress tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	1.2%	1.2%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	29	29
Avg. grace period	7	7

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

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2031. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

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

Figure 2. Solomon Islands: Indicators of Public Debt Under Baseline Scenarios, 2021–31 1/

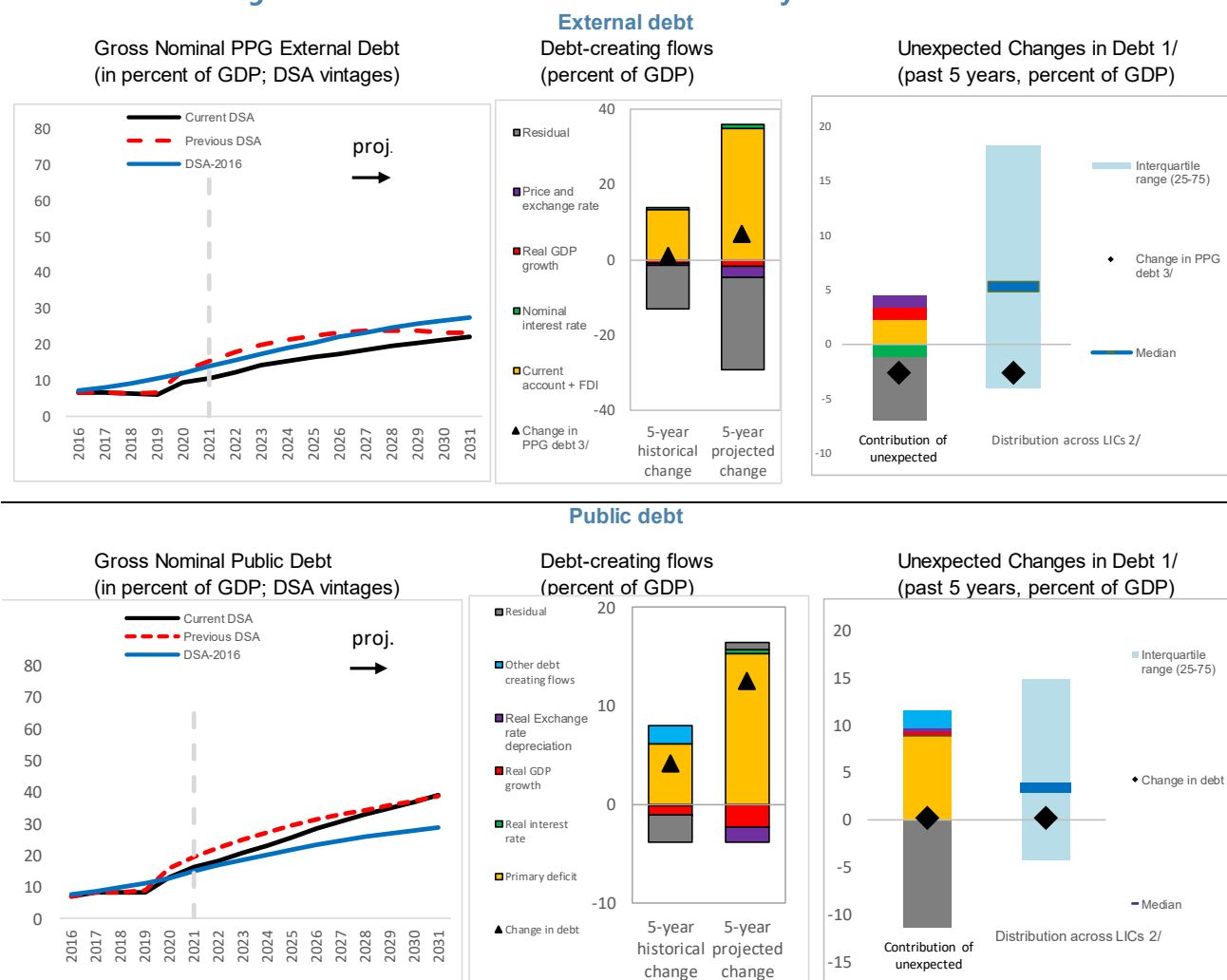
Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	51%	51%
Domestic medium and long-term	39%	39%
Domestic short-term	10%	10%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	1.2%	1.2%
Avg. maturity (incl. grace period)	29	29
Avg. grace period	7	7
Domestic MLT debt		
Avg. real interest rate on new borrowing	2.0%	2.0%
Avg. maturity (incl. grace period)	14	14
Avg. grace period	13	13
Domestic short-term debt		
Avg. real interest rate	-3.1%	-3.1%

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

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2031. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

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

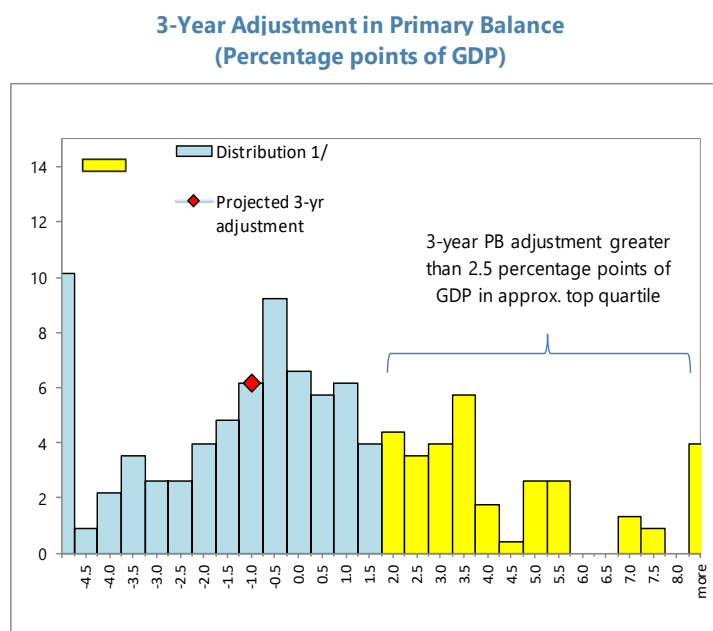


1/ Difference between anticipated and actual contributions on debt ratios.

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

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

Figure 4. Solomon Islands: Realism tools



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

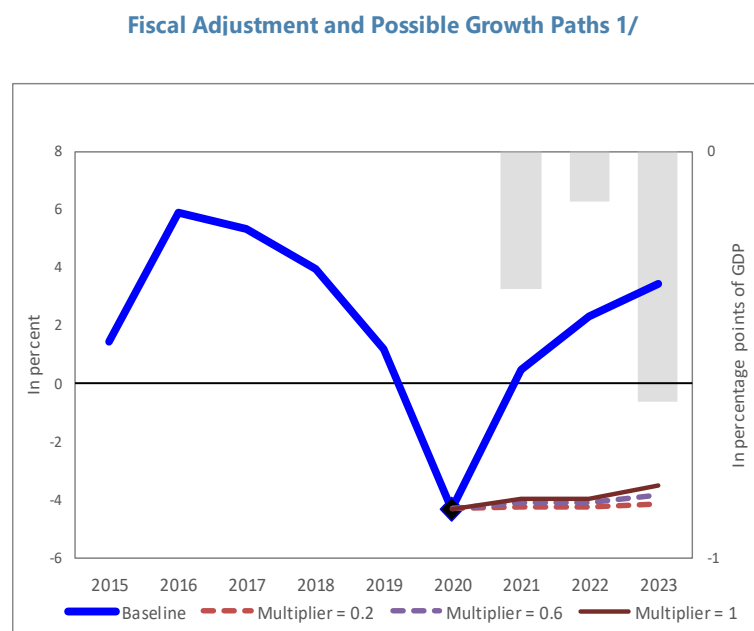


Figure 5. Solomon Islands: Qualification of the Moderate Category, 2019–29 1/



Sources: Country authorities; and staff estimates and projections.

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

**Statement by Chang Huh, Executive Director for Solomon Islands and Laura Johnson,
Senior Advisor to Executive Director
January 7, 2022**

The Solomon Islands is a small, fragile and low-income country of around 700,000 people, speaking over 120 languages. The Solomon Islands' land mass of around 28,400 square kilometers extends over nearly 1,000 islands and spreads over 1.34 million square kilometers of ocean. Its dispersed population, large infrastructure needs, narrow economic base, and exposure to natural disasters and commodity price volatilities pose many development challenges. The authorities are aware of the macroeconomic risks the country faces and appreciate the analysis, advice and ongoing technical assistance provided by the Fund.

Economic Outlook and Risks

The global pandemic has had a severe impact on the Solomon Islands economy exacerbating existing vulnerabilities and recent social unrest has had a further negative impact on the already weak and sluggish economy. In late November, social unrest led to violent protests and significant damage to buildings and businesses in Honiara. The unrest is driven by longstanding socioeconomic vulnerabilities as well as geopolitical disagreements stemming from the province of Malaita, one of the largest and most populous islands. Australia, New Zealand, Fiji and Papua New Guinea sent troops to the Solomon Islands to assist with peacekeeping and commence much needed cleanup efforts.

The authorities are now forecasting a reversal in projected growth for 2021 and growth in 2022 will weaken further. Construction is projected to be a source of growth over the coming years as the authorities fast-track infrastructure projects, largely in preparation for hosting the 2023 Pacific Games. But with such extensive damage, the authorities will now need to refocus on rebuilding activities in the near term.

Inflation is expected to increase. The impacts from the unrest will result in inflation rising even further than originally estimated as a result of unexpected food and tobacco shortages adding to the already elevated price pressures. It has been estimated that the unrest has also led to close to 1,000 jobs being affected.

The pandemic remains the other main risk to economic growth prospects, especially community transmission given the low vaccination rates and weaknesses in health infrastructure. The Solomon Islands has so far had no local transmission of COVID-19 thanks to strong and effective containment measures, including border closures and strict mandatory quarantine for returning passengers. However, the containment measures are also dampening growth prospects with the international border not expected to open until the vaccination rate reaches 80 percent. The authorities are considering ways to commence a soft reopening of the border to enable experts and construction workers to enter for infrastructure projects.

Fiscal policy

The Solomon Islands took swift fiscal policy measures in response to the pandemic, directing resources to essential services and the COVID-19 response. The authorities have spent around 3.6 percent of GDP on COVID-19 prevention and containment measures and a stimulus package to protect jobs and incomes.

The Solomon Islands fiscal position is fragile, reflecting broad-based declines across major revenue categories most notably log export duties as well as additional COVID spending. The economic consequences of the unrest will impact on the already stretched fiscal position. The biggest loss to government revenue stems from a monthly loss of around SBD\$20 million in tobacco taxes, but import duties, PAYE and company tax revenue streams are also affected.

The government is already working on a recovery package for businesses to minimize the impact of the social unrest on the economy. It is too early to know the exact details of the policy response, but the authorities anticipate that this will drive additional financing needs for rebuilding efforts. It will be a challenging fiscal task for the authorities to maintain critical services at the same time provide ongoing stimulus to support affected businesses in 2022 and beyond.

Despite this, the authorities remain committed to the current debt management framework and stabilizing public finances. Rebuilding fiscal buffers to strengthen resilience to preexisting vulnerabilities is critical to ensure fiscal sustainability. The main source of financing for the Solomon Islands remains concessional external loans, especially while the authorities are developing a domestic bond market. Debt remains low but will rise over the medium term, but the fiscal anchor, which is set at 35 percent of GDP, remains in place and the authorities are unlikely to breach this anytime soon. The authorities are focused on rebuilding buffers and continuing to build a medium-term fiscal framework that strengthens revenue administration, reduces tax arrears and improves revenue compliance measures and spending is prioritized and controlled to prevent accumulation of arrears.

Monetary and financial sector policy

The Central Bank of Solomon Islands (CBSI) has maintained an expansionary monetary policy stance to mitigate the effects of the pandemic. CBSI provided additional liquidity by reducing the cash reserve requirement and its holdings of central bank bills and bought government bonds in the secondary market. While domestic borrowing has been limited in size, the CBSI is committed to carefully planning and communicating a cohesive exit strategy from quantitative easing to limit risks to monetary policy credibility and its operational independence. The authorities welcome staff advice on this as well as look forward to future engagement on the development a domestic bond market.

Non-performing-loans are expected to increase as a result of the unrest and the authorities are monitoring this closely. The projected downturn of the economy, coupled with the already stretched fiscal situation, will also lengthen the time taken for consumers to reach financial

access points, affect risk-taking appetite of financial institutions to extend credit with confidence, and put huge pressure on debt servicing obligations of domestic households and private sector in the short to medium term.

Correspondent banking relationships remain fragile in the Solomon Islands, as they are in the Pacific region more generally. The authorities agree with staff of the need to continue to strengthen the AML/CFT framework and have sought technical assistance from the Fund. The authorities are also engaging actively in the development of a regional electronic know-your-customer utility, as part of a regional solution to resolving challenges arising from correspondent banking relationships.

Structural reforms

Addressing structural bottlenecks has become more urgent. The pandemic has disrupted progress in poverty and human capital development. The authorities' sustainable logging policy has led them to invest in infrastructure as the next growth driver. Building resilience to climate change is also critical as the Solomon Islands is extremely vulnerable to natural disasters. The authorities welcome the Selected Issues Paper and focused coverage of spending needs for achieving Sustainable Development Goals. The authorities acknowledge the importance of rebuilding fiscal buffers to enable them to respond to natural disasters, the effects of climate change, and to undertake appropriately prioritized human capital and infrastructure investments to increase resilience and diversify growth potential.

Governance safeguards

The authorities remain focused on transparency and governance safeguards to ensure spending transparency. The establishment of the Oversight Committee to oversee the COVID-19 stimulus spending will guard against misuse of the package and is being continually monitored and evaluated. The authorities are also continuing to publish pandemic-related procurement documents and an audit by the Solomon Islands Office of the Auditor General of COVID-19 related expenditures will be completed in 2022. CBSI will also undergo an update to their Safeguards Assessment in 2022.

Conclusion

On behalf of our Solomon Island authorities, we thank staff, management and the Executive Board for their continued support to the Solomon Islands, especially during these challenging times.

The Solomon Islands have benefited from debt service relief through the Catastrophe Containment and Relief Trust and received emergency financing under the RCF/RFI in June 2020, which helped them to close financing gaps.

The authorities continue to highly value the capacity development and technical assistance provided by the Fund and especially welcome continuing assistance on public financial

management. In this regard, well targeted CD that will assist the authorities meet their governance commitments, such as TA that is planned regarding the audit of COVID expenditures, is most helpful.

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