

**FOR  
INFORMATION**

FO/DIS/21/82

June 9, 2021

To: Members of the Executive Board  
From: The Secretary  
Subject: **Solomon Islands—Assessment Letter for the World Bank**

Board Action: Executive Directors' **information**

Publication: Not yet decided\*

Questions: Mr. Turunen, APD (ext. 36662)



## **Solomon Islands—Assessment Letter for the World Bank**

### **June 8, 2021**

#### **Recent Developments, Outlook and Risks**

**1. The COVID-19 pandemic has had a severe impact on the Solomon Islands economy.** The authorities have enacted strong and timely measures to contain COVID-19, which have successfully prevented a domestic outbreak. However, strict containment measures together with supply-chain disruptions also weigh on the economy. Growth is estimated to have declined to about -4.3 percent in 2020, reflecting a fall in logging and fisheries exports, a contraction in tourism, and delayed infrastructure projects and related activity. While official unemployment data are not available, data from the National Provident Fund suggest a significant decline in formal employment. After a temporary surge in food prices in the first quarter of 2020, inflation has remained muted owing to weak demand and decline in energy prices. The fiscal deficit is estimated to have widened to 2.4 percent of GDP in 2020, with sizeable payment arrears reportedly re-emerging and the cash balance remaining well below the staff recommended minimum of two months of spending. The current account is estimated to have recorded a deficit of 1.8 percent of GDP in 2020. Favorable donor inflows and various official disbursements, including the Rapid Credit Facility/Rapid Financing Instrument (RCF/RFI), to support the authorities COVID-19 policy response contributed to the build-up of foreign reserves. At end-March 2021, foreign reserves stood at US\$656 million (about 10 months of prospective imports), well above the reserve adequacy range of four to seven months of imports.

**2. The economy is projected to recover gradually, but fiscal pressures continue and public debt is expected to increase.** Growth is expected to pick up to 1.5 percent in 2021, with the initial recovery phase hampered by ongoing pandemic-related disruptions. Inflation is projected to increase in 2021 reflecting higher commodity prices. Reflecting the 2021 budget released in April, the fiscal deficit is projected to widen slightly to 2.5 percent of GDP, driven by higher spending on public investment projects, and the cash balance is projected to fall further. The current account deficit is projected to increase to 10 percent of GDP driven by rebound in imports in line with economic recovery, particularly in construction, and reduction in official transfers (after the spike in 2020 related to the pandemic support). Reserve coverage is projected to fall to about 8.4 months of prospective imports this year and to fall further over the medium-term. Economic growth is expected to increase in the near-term, assuming gradually easing health restrictions with effective vaccine roll-out, and reflecting an ambitious pipeline of infrastructure projects (including those related to the 2023 Pacific Games), with medium-term annual growth rate projected at around 3 percent. Fiscal pressures are expected to continue in the medium term as revenues fall from decline in logging activity and infrastructure investments increase. Public debt is expected to rise significantly.

**3. The outlook is subject to significant uncertainty, with risks skewed to the downside.** Solomon Islands has so far had no domestic transmission of COVID-19. However, any domestic

transmission could lead to a significant increase in human and economic costs. New variants of the virus are an added risk factor while vaccination delays could postpone a return to normal activity. Fiscal risks have increased and the decline in the cash balance limits ability to respond to further shocks, heightening risks stemming from social spending gaps, natural disasters, and other external shocks. Additional downside risks include political instability from possible social discontent, 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 possible regional opening and acceleration in infrastructure investment could spur a stronger recovery.

## **Policy Response and Settings**

**4. The government has taken swift measures to mitigate the impact of the pandemic, directing resources to essential services and the COVID-19 response.** Planned additional spending towards health and containment measures and fiscal stimulus amounted to about 3.6 percent of GDP in 2020, with stimulus spending targeted at providing social assistance, protecting jobs and incomes, stabilizing the domestic economy, and supporting the economic recovery. Execution of the economic stimulus package announced in 2020 has continued in 2021, with over 64 percent of the funds reported to have been disbursed by early March this year. The parliament approved the 2021 Budget Appropriation Bill in early April, 2021. The Budget focuses on three key policy objectives: (i) protecting economic and social wellbeing through improved service delivery and preventing the spread of COVID-19; (ii) improving the quality of spending and redirecting resources to support the economic recovery; and (iii) maintaining prudent macroeconomic and fiscal management and ensuring responsible and fiscally sustainable implementation within the fiscal framework. The budget aims to stabilize public sector workforce, streamline and reprioritize other recurrent expense to key essential services, redirect development resources towards the productive and resource sector, and strengthen rural development.

**5. Further fiscal support is needed in the short term while implementing governance safeguards to ensure spending transparency.** To provide continued support to the economy, the government should complete the execution of its stimulus package in 2021 as planned and prioritize measures to safeguard health security (including vaccination for the population), while identifying additional financing to provide targeted lifeline support to vulnerable households and business, and settling domestic payment arrears to help reboot private sector activity. An Oversight Committee has been established to oversee the COVID-19 stimulus spending and guard against any abuse or misuse of the package, including through an on-going multistage monitoring and evaluation process. Building on the good practice of publishing information on stimulus recipients on its website, the authorities are working towards publishing crisis-related procurement documents, including the names of the entities awarded the contracts and their beneficial owners and an audit by the Solomon Islands Office of the Auditor General of COVID-19 related expenditures (before December 2021), in line with their RCF/RFI commitments.

**6. Post-pandemic policy should focus on rebuilding fiscal buffers and establishing a comprehensive medium-term fiscal strategy to support the recovery.** A gradual fiscal consolidation should start once the economic recovery is firmly underway. There is room to raise revenues through strengthening revenue administration, reducing tax arrears and improving compliance, and to rationalize spending through better planning, discretionary spending restraint and prioritization in line with the National Development Strategy. While preserving space for priority spending on health, education and social protection, the government should aim to gradually rebuild fiscal buffers towards a broad cash balance of at least two months of total spending (equivalent, in 2021 terms, to about 3.5 percent of GDP).

**7. Public debt is currently low but is expected to rise over the medium term.** The 2019 Article IV Debt Sustainability Analysis (DSA) concludes that Solomon Islands is at moderate risk of debt distress. All debt indicators remain below the relevant indicative thresholds under the baseline scenario, but breach thresholds under the extreme stress scenario. The June 2020 preliminary DSA update (published in the IMF 2020 RCF/RFI program report) suggests that Solomon Islands remains at moderate risk of debt distress, with substantial space to absorb shocks and room for additional concessional borrowing to support the recovery. In this context, a comprehensive approach to medium-term fiscal policy that safeguards debt sustainability is needed. Updating the medium-term debt management strategy, strengthening fiscal governance by improving budget planning in line ministries, strengthening commitment controls and procurement planning, and prioritizing spending in line with the National Development Strategy would help safeguard fiscal sustainability.

**8. The Central Bank of the Solomon Islands (CBSI)'s expansionary monetary policy remains appropriate.** The monetary policy stance is appropriate for current conditions of low growth and inflation, although the transmission channels are weak. Addressing constraints on National Provident Fund investment abroad, stemming CBSI valuation losses, and tackling weak investor protection and uncertain property rights would reduce excess liquidity, enable collateralized lending, and improve monetary policy effectiveness. CBSI has also purchased government bonds valued at SI\$60 million in the secondary market. Any additional purchase of government bonds in the secondary market should continue to be undertaken in a transparent manner and should be limited in time and scale. Once the economic recovery is firmly underway, 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. Financial sector reforms should continue, including to strengthen supervision and increasing capacity to respond effectively to risks to the financial system. Action should be taken to ensure the effectiveness of the AML/CFT framework to prevent future risks, including from correspondent banking pressures.

**9. Addressing structural bottlenecks has become more urgent following the COVID-19 crisis.** The recovery presents an opportunity to address climate change risks, reduce inequality and advance digitalization. The government should pursue sustainable logging in the forestry sector and foster export diversification. The COVID-19 crisis has demonstrated potential benefits from improved connectivity and digitalization, with underlying infrastructure bolstered by the new undersea internet

cable. Complementary investment in human capital and physical infrastructure, combined with a sound regulatory framework and affordable essential services, could help grow new sectors and improve social development. Building resilience to climate change is critical as Solomon Islands is vulnerable to natural disasters and the impact of rising temperatures and sea levels from global warming on lives and livelihoods. Greening the recovery would boost near-term demand and reduce the future costs of climate change.

### **IMF Relations**

**10.** Solomon Islands successfully completed an IMF-supported program, the Extended Credit Facility arrangement, in March 2016. Solomon Islands is on a standard 12-month Article IV consultation cycle. The 2019 Article IV consultation was concluded by the IMF's Executive Board on February 5, 2020. As part of the Fund's response to help address the impact of the COVID-19 pandemic, Solomon Islands has received three rounds of debt service relief through the Catastrophe Containment and Relief Trust (CCRT) and received emergency financing under the RCF/RFI in June 2020. The remote 2021 Article IV Consultation mission is tentatively scheduled for the second half of October.

**Table 1. Solomon Islands: Selected Economic Indicators, 2017–2023**

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

Population (2019): 721,455 (p)

	2017	2018	2019	2020	2021	2022	2023
				Est.	Proj.		
<b>GROWTH AND PRICES</b>	Annual percentage change unless otherwise indicated						
Real GDP	5.3	3.9	1.2	-4.3	1.5	4.5	4.3
CPI (period average)	0.5	3.5	1.6	3.0	2.6	3.2	3.3
CPI (end of period)	2.1	3.8	2.7	-2.5	4.0	3.6	3.5
GDP deflator	1.4	2.9	1.3	3.4	3.5	5.1	4.9
Nominal GDP (in SI\$ millions)	11,703	12,522	12,834	12,693	13,332	14,640	16,016
<b>CENTRAL GOVERNMENT OPERATIONS</b>	In percent of GDP						
Total revenue and grants	39.2	40.4	32.8	31.5	32.2	32.8	31.2
Revenue	30.2	30.5	26.4	24.5	24.4	24.7	24.5
Grants	9.0	9.9	6.3	7.0	7.8	8.2	6.8
Total expenditure	42.7	39.5	34.2	33.9	34.7	35.8	36.3
excluding grant-funded expenditure	33.6	29.6	27.9	26.9	26.9	27.7	29.6
Recurrent expenditure	29.2	29.5	25.6	26.5	23.8	23.9	23.9
Development expenditure	13.5	10.0	8.6	7.4	10.9	12.0	12.4
Unrecorded expenditure	-0.7	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-3.4	0.9	-1.5	-2.4	-2.5	-3.0	-5.1
Foreign financing (net)	0.9	0.4	1.0	1.0	2.6	2.3	4.2
Domestic financing (net)	1.9	-1.2	0.4	1.4	-0.1	0.7	0.9
Central government debt 1/	8.5	8.2	8.3	14.0	16.0	17.3	20.2
External Debt	6.9	6.2	6.1	10.0	11.8	12.8	15.4
Domestic Debt	1.6	2.0	2.2	3.9	4.2	4.5	4.8
<b>MACROFINANCIAL</b>	Annual percentage change (end of year)						
Credit to private sector	6.4	4.1	3.9	0.3	3.7	6.2	5.0
Broad money	3.5	6.8	-3.1	6.6	-15.0	-4.9	11.9
Reserve money	7.5	10.6	1.3	14.5	-14.0	-8.6	6.4
<b>BALANCE OF PAYMENTS 2/</b>	In US\$ millions unless otherwise indicated						
Trade balance (goods and services)	-81.7	-67.6	-161.6	-131.8	-234.9	-337.5	-316.9
(percent of GDP)	-5.6	-4.3	-10.2	-8.4	-14.3	-18.7	-16.1
Current account balance	-62.8	-47.8	-154.0	-27.4	-164.9	-272.1	-270.1
(percent of GDP)	-4.3	-3.1	-9.8	-1.8	-10.1	-15.1	-13.7
Foreign direct investment (+ = decrease)	-35.9	-15.9	-28.7	-5.6	-43.8	-62.1	-64.0
(percent of GDP)	-2.5	-1.0	-1.8	-0.4	-2.7	-3.4	-3.2
Overall balance (+ = decrease)	-41.2	-57.4	33.7	-24.0	-15.2	48.2	28.2
Gross official reserves (in US\$ millions, end of period) 3/	576.9	613.1	574.2	631.0	645.9	597.5	564.2
(in months of next year's imports of GNFS)	9.3	9.8	12.2	10.2	8.4	7.3	6.5
<b>EXCHANGE RATE (SI\$/US\$, end of period)</b>	7.9	8.1	8.2	8.0	...	...	...
Real effective exchange rate (end of period, 2010 = 100)	126.3	126.5	127.1	132.9	...	...	...
<b>MEMORANDUM ITEMS:</b>							
Broader cash balance (=Cash balance+ SIG Deposit Account; in SI\$ millions)	483	451	346	326	120	120	120
in months of total spending 4/	1.5	1.5	1.2	1.1	0.4	0.4	0.3

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

1/ Includes disbursements under the IMF-supported programs.

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

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

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