

**FOR
AGENDA**

EBS/83/261
Correction 1

CONFIDENTIAL

January 4, 1984

To: Members of the Executive Board

From: The Acting Secretary

Subject: Solomon Islands - Staff Report for the 1983 Article IV
Consultation and Review Under the Stand-By Arrangement
and Request for Modifications of Performance Criteria

The following corrections have been made in EBS/83/261 (12/2/83):

Page 28, para. no. 2, third line from bottom: for "SI\$38.4 million"
read "SI\$38.3 million"

Page 31, para. no. 10, line 1: for "15 percent" read "17 percent"

Corrected pages are attached.

Att: (2)

Solomon Islands: Basic Data

Area:	27,556 square kilometers
Population (1983):	249,000
Population growth (annual average 1979-82)	3.5 percent
GDP per capita (1983):	SDR 574

	1981	1982	1983 Estimate	1984 Projection
<u>Output and prices</u> (Annual rate of change in percent)				
Real GDP	1.6	-0.2	2.0	5.0
Consumer prices (annual average)	16.4	13.0	8.0	6.0
<u>Money and credit</u> (Annual rate of change in percent) ^{1/}				
Broad money	-14.1	22.5	20.8	13.4
Total domestic credit	20.5	14.5	11.7	10.3
Credit to private sector	12.3	3.8	6.5	8.2
<u>Public finance</u> (Annual rate of change in percent)				
Domestic revenue	34.2	12.3	5.9	17.5
Current expenditure	33.6	10.9	11.8	6.3
Capital expenditure and net lending	6.0	-13.1	1.3	12.9
Total expenditure	22.4	2.4	8.6	8.1
<u>Foreign trade</u> (Annual rate of change in percent)				
Export volume	9.7	-4.9	5.8	14.5
Export unit value	-9.2	-1.4	1.4	6.0
Import volume	-2.2	-18.0	4.0	9.0
Import unit value	15.5	1.3	-1.8	6.0
Terms of trade	-21.4	-2.7	3.3	—
<u>Balance of Payments</u> (SDR million)				
Exports (f.o.b.)	56.2	52.7	56.6	68.9
Imports (f.o.b.)	-64.4	-53.5	-54.6	-63.2
Trade balance	-8.2	-0.8	2.0	5.7
Current account balance	-37.4	-19.8	-19.4	-17.9
Overall balance	-8.9	4.6	1.9	1.2
<u>Gross international reserves</u> (End of period)				
In millions of SDRs	18.5	33.7	41.2	42.4
In months of imports of goods and services	2.6	4.7	5.0	4.7
<u>Selected financial ratios</u> (In percent)				
Current account/GDP	-27.2	-13.4	-13.6	-11.5
Government budget deficit/GDP	-12.8	-9.6	-10.1	-7.9
External debt/GDP ^{2/}	11.4	21.3	26.5	27.5
External debt service ratio ^{3/}	1.2	3.6	2.7	3.5
Oil imports/total imports	23.0	25.0	25.5	24.7

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

^{1/} In relation to stock of broad money at beginning of period.

^{2/} External public sector debt.

^{3/} Interest plus amortization on public debt as ratio of exports of goods and services.

Honiara, Solomon Islands

December 1, 1983

Dear Mr. de Larosiere:

1. In our letter of April 21, 1983, we requested a stand-by arrangement for a period of one year through June 21, 1984 in an amount of SDR 2.4 million. This request was approved by the Executive Board of the Fund in June 1983. It was agreed at that time that the authorities would review the developments under the program supported by the stand-by arrangement and would reach with the Fund before December 31, 1983, understandings regarding the Government's budgetary policy as well as quantitative performance criteria for the remaining period of the stand-by arrangement.

2. Performance under the program has exceeded expectations in respect of the balance of payments and domestic price inflation. A combination of external events and the policy measures we have undertaken in fiscal, monetary, and exchange rate management, has improved the external position more rapidly than we earlier forecast. We would, however, like the stand-by arrangement to remain in place until it expires in mid-1984. Subject to the modifications we request in this letter, we intend to continue to carry out our express commitments under this stand-by arrangement.

3. Performance under the domestic credit ceilings has been below our expectations. Total domestic credit has not come close to the agreed ceiling, reflecting a rather quiet period in direct investment and a wait-and-see attitude by existing enterprises in view of the recession in world trade. Net credit to the Government, on the other hand, has persistently pressed against the agreed ceiling and at the end of September stood at SI\$3.9 million, against the agreed ceiling of SI\$2.0 million. The level of the Government's use of short-term bank financing has proved particularly resistant to the strenuous efforts by the Government to reduce it. It has arisen from the need to bridge the twin gaps between current revenues and expenditures and between aid receipts and development project outlays. We are now expecting a swing into current surplus in the last two months of the year, and a catching-up of aid receipts against expenditures, which we expect to reduce the Government's use of bank credit to no more than SI\$3.0 million by the end of the year. We therefore request a modification to the relevant performance criterion for the last quarter of 1983 from SI\$1.8 million to SI\$3.0 million. The corresponding ceiling on total domestic credit should be brought down from SI\$38.3 million to SI\$34.0 million in recognition of slower than expected private borrowing, and the effects on broad money of the recent improvement in the external trade balance.

recourse to domestic financing to SI\$3.0 million, of which not more than SI\$1 million will be provided by the banking system. Measures to ensure the improved control necessary to achieve this will include implementation of the administrative changes recommended by the recent Fund technical assistance mission.

10. Total government revenue is expected to grow by 17 percent to SI\$44 million. The projected revenue growth reflects the expected growth in international trade and the estimated impact of the revenue measures we intend to take in 1984. These include an increase in export duty on logs to a uniform rate of 15 percent, a special levy on timber exports for the Forest Fund and a number of adjustments in fees and charges for government services. Copra export duty was reintroduced in September 1983. The additional government revenue from these new measures is estimated at over SI\$3.0 million, or about 2 percent of estimated GDP.

11. The government budget provides for current expenditure of SI\$42 million. This incorporates an increase in wages and salaries of 6 percent. Lower rates of nominal increase are allowed to low priority areas of the budget. Increases of 10 percent in nominal terms will be allowed to priority sectors including education and training, health and the development of provincial government. In the development budget, government expenditure will concentrate on infrastructure in support of economic development, and on investment in education and training.

12. The main objective of monetary policy during 1984 will be to finance the investment and operating costs of the economy as it picks up speed to a growth rate of 5 percent or more, while guarding against any tendency to widen the balance of payments deficit to more than 14 percent of GDP in the medium term, or to add domestic price pressures to the expected rise in import costs. To achieve this, the growth of total domestic credit of the banking system will be limited to 15 percent during 1984. This increase of SI\$5.0 million in total domestic credit comprises SI\$1.0 million increase in net lending to the Government and SI\$4.0 million to the private sector. Together with the projected increase in net foreign assets of the banking system of SI\$1.5 million, it is consistent with an estimated growth of 13 percent in broad money during the year. To achieve the above objective, we will limit total domestic credit of the banking system and net credit to the Government in the first half of 1984 as indicated in the attached table. The credit program takes into account the seasonal pattern we expect in economic activity.

13. To promote the mobilization of savings through the financial system, the Central Bank will continue to maintain key interest rates positive in real terms. In implementing this policy, the Bank will also take into account interest rate movements in neighboring countries and their implications for capital flows. In addition to interest rate policy, we shall endeavor to develop the financial system and improve banking services to facilitate the mobilization of domestic savings.

14. We have implemented a flexible exchange rate policy in 1983. We remain committed to managing the exchange rate in 1984 so as to preserve the competitive position of Solomon Islands and the profitability of exports.

15. The Government will continue a cautious policy in the management of external debt in 1984. In line with this policy, during the period from January 1, 1984 to June 30, 1984, the contracting of new public and publicly guaranteed external nonconcessional borrowing with an original maturity of more than 1 year and up to and including 12 years will not exceed US\$5 million. The Government will not contract any new public or publicly guaranteed external borrowing with original maturities of one to five years.

Yours sincerely,

/s/

A.V. Hughes
Governor
Central Bank of Solomon Islands

/s/

Bartholomew Ulufa'alu
Minister of Finance

Attachment

Mr. J. de Larosiere
Managing Director
International Monetary Fund
Washington, D.C., 20431
U.S.A.