

EBS/83/81
Correction 1

CONFIDENTIAL

June 20, 1983

To: Members of the Executive Board
From: The Secretary
Subject: Solomon Islands - Request for Stand-By Arrangement

The following corrections have been made in EBS/83/81 (4/22/83):

Page 24, para. 1, lines 2-3: for "May , 1983 to May , 1984"
read "June , 1983 to June , 1984"

Page 30, item 1, line 1: for "beginning May , 1983"
read "beginning June , 1983"

Corrected pages are attached.

Att: (2)

Budgetary policy is of crucial importance for ensuring attainment of the external objectives, while enabling a recovery of private investment. The staff supports the focus of fiscal policy on restraint in current expenditures and on coordinated efforts to implement public projects expeditiously. Given the constraints on the growth of domestic revenue in a period of economic weakness, restraint in the growth of current government expenditure in 1983 is all the more essential in containing the overall budget deficit within the programmed level and attaining the overall balance in the economy. Efforts should also be made to raise the implementation rate of public investment in infrastructure in order to support the recovery in private investment and facilitate the greater inflow of grants and concessional external loans.

Monetary policy should be conducted in a manner that covers the credit needs of the private sector in an environment of financial stability. The present financial program, which envisages a limited access to bank credit by the Government but ample credit to the private sector within prudent overall credit limits, will help sustain economic recovery. The staff welcomes the recent upward adjustment of interest rates on bank deposits for the purpose of attracting more financial savings into the banking system. Investment decisions taken in the light of a realistic cost of capital will promote efficiency in the use of resources and facilitate attainment of the Government's objective of diversifying the productive base of the economy into areas where Solomon Islands has a comparative advantage.

The sharp reduction in the external deficits on trade and the current account in 1982 reflected mostly the underlying weakness of the economy. As investment recovers in 1983, some increase in these deficits can be expected. The projected increase in the current account deficit is consistent with Solomon Islands' capacity to service the present and projected levels of external debt. Prospects for achieving the projected aid inflows during 1983-84 are good. In recent years, the Government has had access to foreign grants and highly concessional loans in excess of its capacity to identify and implement projects. This trend is expected to continue during 1983-84. Also, given the focus of investment on the export sector, the projected increase in external deficits is in line with a medium-term strategy of development and growth in the context of a sustainable external position. The increased flexibility in exchange rate policy should help enhance export profitability and ensure the maintenance of balance of payments viability.

In the staff's view, the objectives and policies for 1983, described in the annexed letter, represent a suitable response to short-term developments and are consistent with an appropriate path of external adjustment over the medium term. Efforts being made by the Solomon Islands authorities deserve the support of the Fund. Accordingly, the following draft decision is proposed for adoption by the Executive Board:

1. The Government of Solomon Islands has requested a stand-by arrangement for the period from June , 1983 to June , 1984 for an amount equivalent to SDR 2.4 million.

2. The Fund approves the stand-by arrangement attached to EBS/83/81 and Correction 1.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

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Solomon Islands: Summary of the Financial Program

Assumptions:	Terms of trade	-3.5 per cent
	(Export prices)	(-5.0 per cent)
	(Import prices)	(-1.5 per cent)
	Real GDP growth	3.0 per cent
Targets: (1983)	Inflation	10 per cent
	Balance of Payments	
	Current account deficit	SDR 25.2 million (16.8 per cent of GDP)
	Overall deficit	SDR 2.5 million (1.6 per cent of GDP)

Principal elements of the program

1. Exchange rate

10 per cent depreciation in August 1982.
Flexible exchange rate policy aimed at maintaining export competitiveness.

2. Investment

To encourage private investment through exchange rate policy, fiscal incentives, and more active involvement by the Government Shareholding Agency.

3. Budget

To reduce the current account deficit (excluding grants) from 0.5 per cent of GDP in 1982 to a surplus of 0.3 per cent in 1983, and to reduce recourse to domestic borrowing to SI\$2.1 million (1.2 per cent of GDP).
To raise the implementation rate of developments projects to close to 65 per cent. To contain the overall deficit to SI\$17.8 million (10 per cent of GDP).

4. Money and credit

To limit total credit expansion to 22 per cent and net credit to the Government to 1.4 per cent of stock of liquidity at end-1982 and monetary expansion to 14.5 per cent with appropriate quarterly ceilings as performance criteria.
Increases in interest rates on deposits averaging 2 to 3 percentage points in early March 1983.
The income velocity of money is assumed to decline slightly in 1983.

5. External medium-term borrowing

To limit public and publicly guaranteed external borrowing with maturities of 1 to 12 years to US\$5 million and no borrowing in the 1- to 5-year maturity range.

6. Review

Progress under the program will be reviewed no later than December 31, 1983, and understandings will be reached on policies and quantitative performance criteria for the first quarter of 1984.

Solomon Islands--Stand-By Arrangement

Attached hereto is a letter dated April 21, 1983 from the Minister of Finance of Solomon Islands and the Governor of the Central Bank of Solomon Islands requesting a stand-by arrangement and setting forth: (a) the objectives and policies that the authorities of Solomon Islands intend to pursue for the period of this arrangement; (b) the policies and measures that the authorities of Solomon Islands intend to pursue for the period through December 31, 1983; and (c) understandings of Solomon Islands regarding the review that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Solomon Islands will pursue for the remaining period of this arrangement. To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For a period of one year beginning June , 1983, Solomon Islands will have the right to make purchases from the Fund in an amount equivalent to SDR 2.4 million, subject to paragraphs 2, 3 and 4 below, without further review by the Fund.

2. Purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 0.48 million until July 31, 1983, the equivalent of SDR 0.96 million until October 31, 1983, and the equivalent of SDR 1.44 million until January 31, 1984, and the equivalent of SDR 1.92 million until April 30, 1984, but none of these limits shall apply to a purchase under the stand-by arrangement that would not increase the Fund holdings of Solomon Islands' currency in the credit tranches beyond 25 per cent of quota.

3. Solomon Islands will not make purchases under this arrangement that would increase the Fund holdings of its currency in the credit tranches beyond 25 per cent of quota:

(a) During any period through December 31, 1983 in which the data at the end of the preceding period indicate that the limits on total domestic credit of the banking system or the limits on net credit from the banking system to the Government referred to in paragraph 14 of the attached letter and the table attached thereto are not observed; or

(b) After December 31, 1983 until suitable performance criteria have been established in consultation with the Fund as contemplated by paragraph 19 of the attached letter, or after such performance criteria have been established, while they are not being observed;

(c) During the entire period of this stand-by arrangement, if Solomon Islands

(i) imposes or intensifies restrictions on payments and transfers for current international transactions, or