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CONFIDENTIAL

July 15, 1987

To: Members of the Executive Board
From: The Secretary
Subject: Solomon Islands - Real Effective Exchange Rate -
Information Notice

Attached for the information of the Executive Directors is an information notice on the real effective exchange rate of the Solomon Islands dollar.

Mr. Baumgartner (ext. 7307) is available to answer technical or factual questions relating to this paper.

Att: (1)

INTERNATIONAL MONETARY FUND

SOLOMON ISLANDS

Real Effective Exchange Rate - Information Notice

Prepared by the Asian Department and
the Exchange and Trade Relations Department

(In consultation with the Legal Department
and the Research Department)

Approved by P. R. Narvekar and H. B. Junz

July 14, 1987

The recent evolution of Solomon Islands' real effective exchange rate, as measured by the standard index developed in connection with the information notice system, is set out in the attached table and chart. Based on this index, as of April 1987, the Solomon Islands dollar had depreciated by 10 1/2 percent since the last occasion on which the Executive Board had an opportunity to discuss Solomon Island's exchange rate policy--the 1986 Article IV consultation in September 1986. 1/

The Solomon Islands dollar is pegged to a basket of the currencies of Solomon Islands' main trading partners. Following a period during which the exchange rate was maintained at a constant level against the official basket, since June 1985 the Solomon Islands dollar has been gradually depreciated against the basket. By April 1987, the nominal and real effective rates, as measured by the standard index used for the information notice system, were, respectively, 43 percent and 32 percent below the May 1985 level.

Balance of payments pressures intensified in 1985-86, mainly reflecting a sharp decline in export prices. A severe cyclone in mid-1986 also contributed to the worsening of the current account position. Export earnings dropped by close to 40 percent between 1984 and 1986 and, despite declining import volume, the current account deficit widened from 5 percent of GDP in 1984 to 28 percent of GDP in 1986. The overall balance was in substantial deficit in 1985, but sizeable inflows of aid following the cyclone and large STABEX grants from the EC resulted in a marked, though temporary, increase in capital inflows and a small overall balance of payments surplus in 1986. However, reserves continued to decline, as Solomon Islands made an early

1/ Chairman's Summing Up circulated as SUR/86/98 (9/23/86).

repayment of a Eurocurrency loan, which had been used in preceding years for reserve management purposes. Gross official reserves at the end of 1986 amounted to SDR 24 million, equivalent to 2 1/2 months of imports of goods and services, down from SDR 46 million at the end of 1984. In the first 4 months of 1987, gross international reserves fell further by about SDR 3 million.

Staff Appraisal

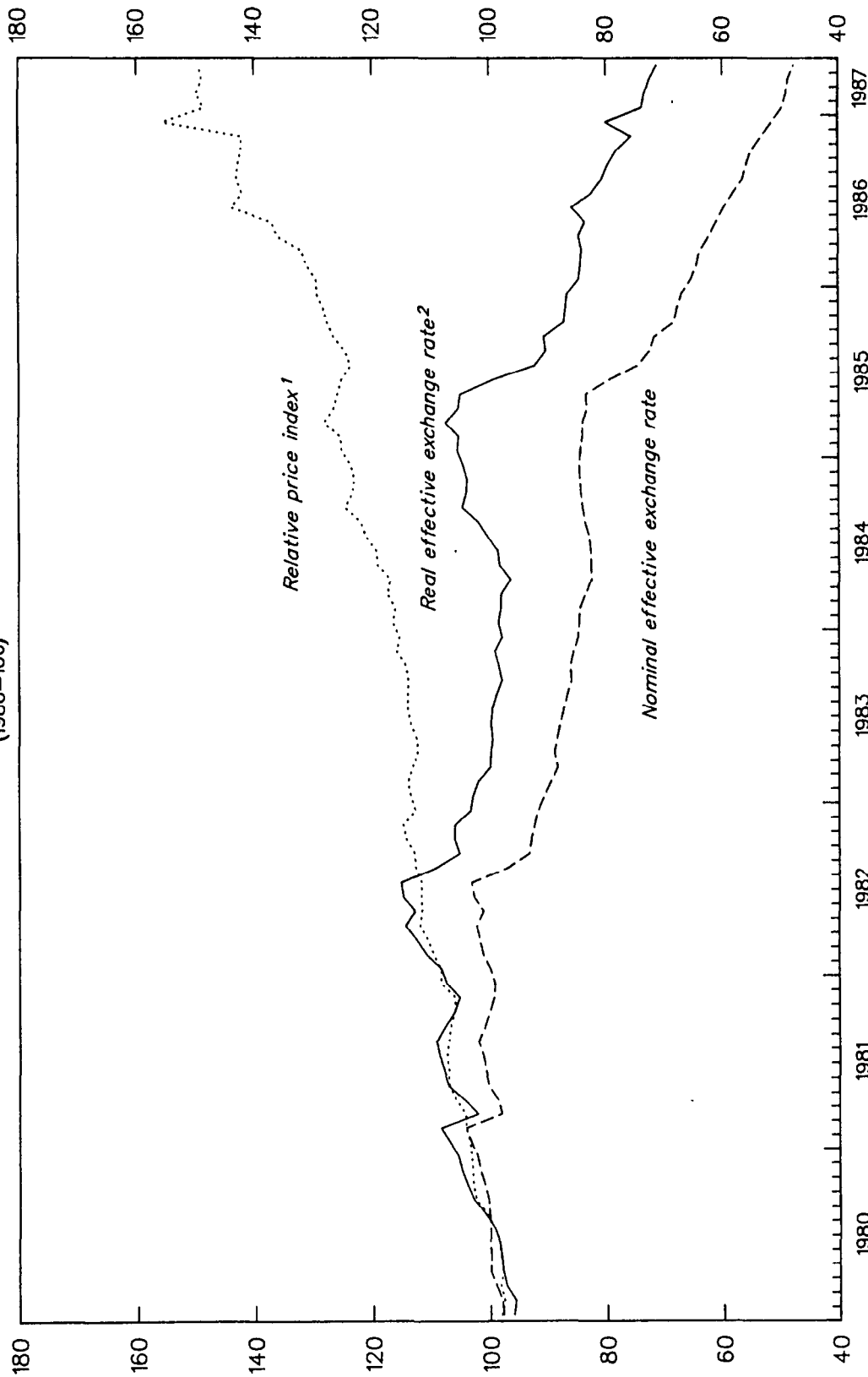
During the last Article IV consultation discussions, Executive Directors expressed concern about a sharp deterioration in export profitability and the prospective large external financing gaps, and stressed the need for continued flexibility in exchange rate policy.

Although export profitability has recovered somewhat in 1987, it is far from robust and the Government has had to provide substantial financial support to some important export industries. There is clearly a need to maintain the flexible management of the exchange rate and ensure that adequate incentives are being provided for the expansion of the export sector through an appropriate exchange rate policy.

Discussions with the authorities for the 1987 Article IV consultation were held in May 1987. The staff report for the consultation, which is to be issued in July 1987, will discuss recent developments in and the outlook for the balance of payments and review and appraise economic policy, including exchange rate policy.

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CHART 1
SOLOMON ISLANDS
INFORMATION NOTICE SYSTEM INDEX OF REAL EFFECTIVE EXCHANGE RATE
(1980=100)



Source: Information Notice System.
¹Seasonally adjusted.
²Trade-weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices; increases mean appreciation.

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Table 1. Solomon Islands: Real Effective Exchange Rate and Related Series, 1982-87

(Indices: 1980 = 100)

	Real Effective Exchange Rate <u>1/</u> <u>2/</u>	Nominal Effective Exchange Rate <u>1/</u>	Relative Consumer Prices (Local Currencies)	Exchange Rate in Terms of U.S. Dollars <u>1/</u>	Consumer Price Index (Seasonally Adjusted)	Consumer Price Index (Not Seasonally Adjusted)
1982						
I	110.5	100.9	109.5	91.8	126.0	125.6
II	114.0	102.0	111.8	90.4	130.4	130.8
III	110.0	97.8	112.4	83.5	133.1	133.7
IV	105.0	92.2	113.9	77.6	136.6	135.9
1983						
I	101.5	89.4	113.5	76.8	137.5	137.1
II	99.6	88.4	112.8	73.2	138.1	138.8
III	98.7	86.6	114.0	70.2	141.2	141.7
IV	98.4	85.5	115.2	69.2	144.7	143.9
1984						
I	98.1	84.1	116.6	68.2	149.0	148.5
II	97.7	82.5	118.4	66.4	152.6	153.5
III	102.3	83.5	122.5	63.4	159.8	160.3
IV	104.0	84.4	123.3	62.7	162.4	161.4
1985						
I	106.0	84.0	126.2	59.4	168.0	167.5
II	103.2	82.0	125.9	58.5	169.8	171.0
III	90.9	72.8	124.9	54.0	170.0	170.4
IV	86.8	67.6	128.4	52.7	175.8	174.7
1986						
I	84.2	64.4	130.7	51.5	180.1	179.6
II	84.6	60.9	139.0	50.0	192.0	193.3
III	80.8	56.7	142.5	46.6	198.1	198.5
IV	77.8	53.1	146.6	43.3	206.4	205.0
1987						
I	73.1	49.1	149.0	41.6	211.3	210.6
1986						
September <u>3/</u>	79.5	55.7	142.7	45.6	199.2	199.6
October	78.0	54.9	142.2	44.9	199.4	199.5
November	75.5	53.2	142.1	43.1	200.2	198.3
December	79.9	51.4	155.5	42.0	219.6	217.2
1987						
January	73.6	49.6	148.4	41.7	209.9	209.3
February	73.2	48.9	149.7	41.4	212.2	211.3
March	72.4	48.7	148.8	41.7	211.7	211.1
April	71.2	47.7	149.3	41.7	213.6	216.7
Percentage change September 1986- April 1987	-10.5	-14.4	4.6	-8.5	7.2	8.6

Source: Information Notice System.

1/ Increases mean appreciation.

2/ Using seasonally-adjusted price indices.

3/ Date of latest consideration by Executive Board.

