

EBS/86/140

CONFIDENTIAL

June 26, 1986

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. Belanger (ext. 8671) 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 Eduard Brau

June 25, 1986

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 the Solomon Islands dollar had depreciated by April 1986 by more than 10 percent since the last occasion on which the Executive Board had an opportunity to discuss Solomon Islands' exchange rate policy--the 1985 Article IV consultation in August 1985. ^{1/} The real depreciation is estimated to have amounted to 13.0 percent.

The Solomon Islands dollar is pegged to a basket of the currencies of Solomon Islands' main trading partners. In August 1982, the dollar was devalued by 10 percent and the weighting of the basket was changed from one based on settlement currencies to one based on trade shares. From September 1982 to April 1984, a flexible policy of managing the exchange rate was pursued. The nominal effective exchange rate was gradually adjusted downward by almost 1 percent per month, resulting in a real depreciation of the Solomon Islands dollar of nearly 15 percent from the second quarter of 1982 to the second quarter of 1984. Subsequently, the authorities maintained the rate at a constant level against the official basket. Staff calculations suggest that from April 1984 to May 1985, the Solomon Islands dollar appreciated by some 10 percent in real effective terms. The authorities resumed the flexible management of the exchange rate in June 1985, and in the period from May 1985 to April 1986, the Solomon Islands dollar depreciated by about 30 percent in nominal effective terms. The real effective depreciation over this period is estimated to have amounted to 24 percent.

The Solomon Islands' balance of payments deteriorated in 1985, with the current account deficit rising to 22 percent of GDP from 6 percent in 1984. This deterioration was attributable primarily to a decline in the value of export earnings by more than 20 percent in SDR terms, which

^{1/} Chairman's Summing Up circulated as SUR/85/96 (9/5/85).

resulted mainly from a sharp fall in world prices of vegetable oils and to a lesser extent from adverse factors affecting the timber and fishing industries. The balance of payments has come under strong pressure in 1986 because of a further decline in export prices and the impact on export and import volumes of a severe cyclone that hit Solomon Islands in May 1986.

Staff Appraisal

The recent real depreciation of the Solomon Islands dollar is broadly in line with the views expressed by Executive Directors during the 1985 Article IV consultation held in August 1985. At that time, Executive Directors welcomed the resumption of a more flexible management of the exchange rate. It was noted that providing adequate price incentives over the medium term was a key element in ensuring continued growth of exports.

Discussions with the authorities for the 1986 Article IV consultation were held in May 1986. The staff report for the consultation will review and appraise recent developments in the exchange rate for the Solomon Islands dollar and in underlying policies. According to the cycle specified during the previous consultation, the 1986 Article IV consultation with the Solomon Islands (including the 3-month grace period) should be concluded by November 28, 1986.

Table 1. Solomon Islands: Real Effective Exchange Rate and Related Series

(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)
Quarterly						
1981						
III	108.8	100.3	108.5	92.7	118.9	119.5
IV	106.2	98.4	107.9	93.2	120.8	120.3
1982						
I	111.0	99.9	111.0	91.8	126.0	125.6
II	114.9	101.3	113.4	90.4	130.4	130.8
III	111.1	97.5	113.9	83.5	133.1	133.7
IV	106.4	92.2	115.4	77.6	136.6	135.9
1983						
I	102.8	89.2	115.3	76.8	137.5	137.1
II	100.3	87.3	114.9	73.2	138.4	138.8
III	98.8	85.2	116.1	70.2	141.1	141.7
IV	97.5	83.0	117.5	69.2	144.5	143.9
1984						
I	97.6	81.4	119.9	68.2	148.8	148.5
II	98.0	79.9	122.6	66.4	153.1	153.5
III	103.0	81.2	126.9	63.4	159.7	160.3
IV	104.3	81.7	127.6	62.7	162.2	161.4
1985						
I	106.3	82.2	129.4	59.4	166.2	166.0
II	105.0	80.6	130.2	58.5	169.7	170.1
III	92.5	70.9	130.5	54.0	171.5	172.1
IV	86.8	65.3	132.9	52.7	176.3	175.5
1986						
I	83.6	61.5	135.9	51.5	181.5	181.2
Monthly						
1985						
August <u>3/</u>	92.4	70.4	131.1	54.1	172.4	173.7
Sept.	91.6	69.6	131.5	53.1	173.1	173.6
Oct.	86.7	66.0	131.5	52.8	173.8	173.9
Nov.	86.8	65.4	132.9	53.0	176.1	175.3
Dec.	86.7	64.5	134.5	52.3	179.0	177.2
1986						
Jan.	84.7	62.8	135.0	51.4	180.0	179.2
Feb.	83.4	61.3	136.0	51.6	181.8	181.5
March	82.6	60.5	136.7	51.7	182.6	182.8
April	80.4	58.6	137.3	50.7	183.4	184.3
Percentage change						
August 1985- April 1986	-13.0	-16.9	4.7	-6.4	6.3	

Source: Information Notice System.

1/ Increases mean appreciation.

2/ Using seasonally adjusted price indices.

3/ Date of latest consideration by Executive Board.

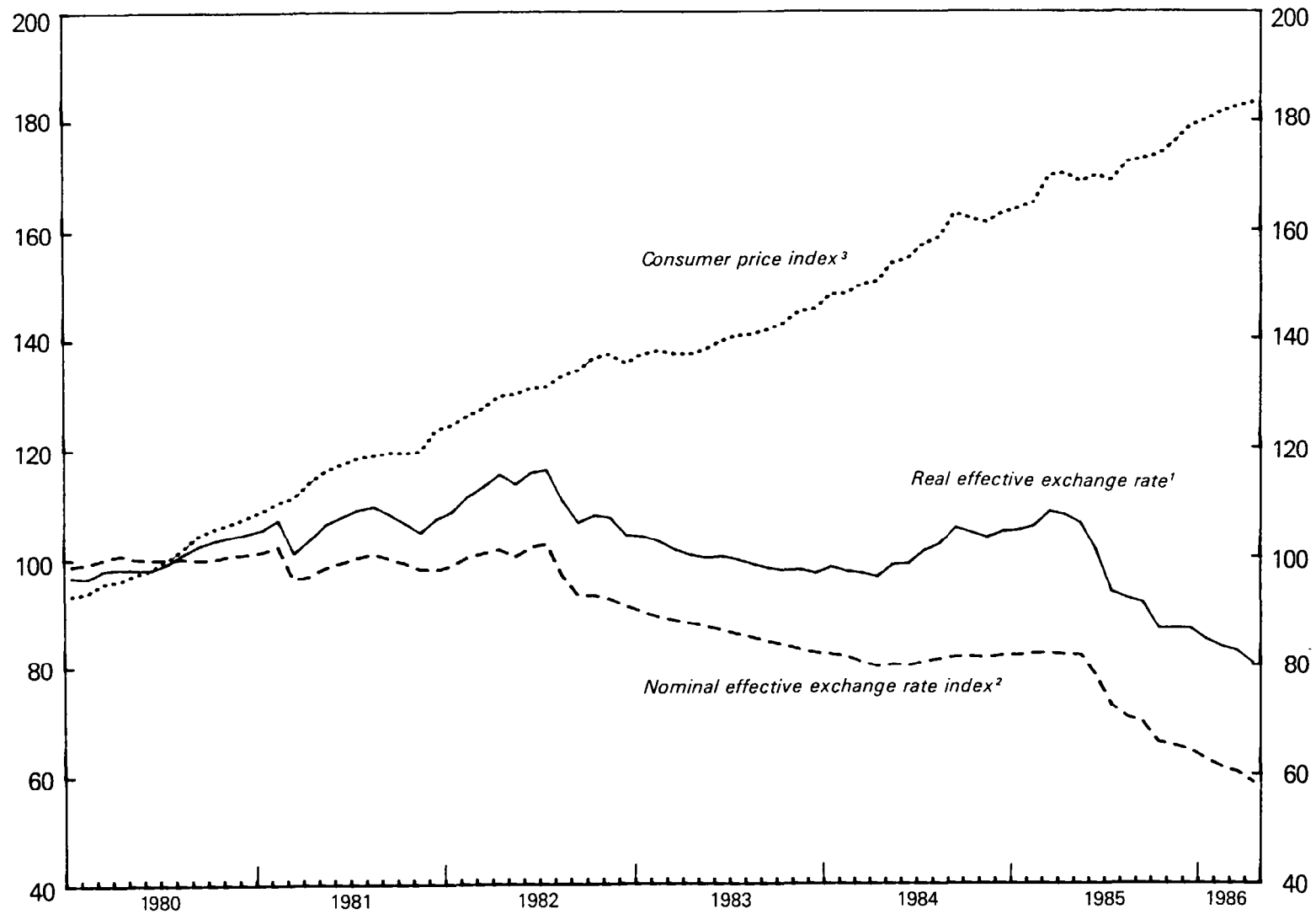
1
1



SOLOMON ISLANDS

INFORMATION NOTICE SYSTEM INDEX OF REAL EFFECTIVE EXCHANGE RATE

(1980 = 100)



Source: Information Notice System.

¹ Trade-weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices: increases mean appreciation.

² Trade-weighted index of nominal exchange rate.

³ Seasonally adjusted.