



CENTRAL BANK OF SOLOMON ISLANDS

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CENTRAL BANK OF SOLOMON ISLANDS WARNS OF UNPRECEDENTED INFLATION

The Central Bank of Solomon Islands (CBSI) has warned that the soaring rate of inflation in the past few months is set to continue, and that inflation will reach unprecedented levels in the months ahead. CBSI, like Government emphasises that there are no easy and short-term solutions to this problem.

In May 2008 annual inflation reached 13.1%, up from 10.0% in December 2007. The driving force behind the high rate of inflation is huge price increases of a few specific goods. As everyone in the country is painfully aware, the price of rice, flour and fuel items have leapt up on a month-by-month basis since the beginning of the year. Thus, the price of rice reached nearly \$200 by the end of June (67% higher than the price at the end of 2007), petrol reached \$10.60 per litre in June (a 46% increase) and kerosene reached \$13.30 in June (an increase of 60%). If you remove the impact of just rice, flour and fuel items, inflation in May was a far more modest 9.8%.

Inflation is set to rise further in 2008. The Bank forecasts that further increases in the price of rice and fuel will push inflation to historically unprecedented levels within the next few months. The problem is made worse by the importance of fuel in nearly all consumption items, causing knock-on effects in the prices of items such as domestic root crops and vegetables, transport and electricity, and all imports through the impact on freight costs.

In contrast to previous periods of high inflation in Solomon Islands, the current price rises in Solomon Islands are not related to domestic policies and economic conditions. For example, inflation of over 15% in late 2002 was largely related to the depreciation of the currency that year, necessary to protect the country's foreign reserves which had fallen to critical levels. Later, the surge in inflation in 2006 to over 13% was driven by increases in the price of domestic goods relating to strong domestic demand. Unlike these two recent episodes, the price increases and high inflation we are experiencing are entirely driven by international factors over which Solomon Islands has no control. Contrary to some opinions, the current high prices are nothing to do with a weak Solomon Islands dollar, which in fact since the end of 2007 has stayed constant with the US dollar, the currency in which rice and fuel are priced.

At the same time, we currently have a large trade deficit and a very precarious state of external reserves, and this rules out the possibility of using the exchange rate to target inflation. Urgent monetary policy measures have been implemented by CBSI, and this should help to ease the domestic causes of inflation a little, but as has been explained the driving factors at present are international prices of major commodities.

CBSI says that there is no easy and quick solution to the commodity price problem in the short-term. SIG measures to remove import and goods taxes on rice were a welcome move, though the approximate 10% reduction in price this policy produced made only a small difference in the face of huge increases in international prices. Efforts to develop domestic rice production may play a role in the medium-term, but probably far more effective will be the country's ability to improve production and supply of domestic root crops and vegetables as part of the rural development strategy. In particular, improvement to infrastructure and transport links will be crucial.

The price of rice will not remain at the current level forever, and with global production expected to reach a record high in 2008 and surge higher in 2009, prices are expected to ease at some point next year. In the meantime, there is little we can do in the Solomon Islands except to tighten our belts and turn to production and consumption of our traditional food items. Unlike many countries in the world, where people depend entirely on rice (or bread) for their staple diet and have experienced widespread hunger as a result of these increases, in Solomon Islands there are easily available local alternative root crops we can fall back on.

The issue of fuel prices is somewhat more problematic. Unlike for rice, in the short-term there is no easy substitute for petrol and kerosene to provide our power, transport and lighting. Also unlike rice, there are many international experts who argue that the current high prices for fuel are here to stay. The knock-on effect of high fuel prices has already been seen in the increase in bus fares in Honiara, and further impacts will be seen on electricity bills and domestic food items. In the short-term, we can reduce our expenses on fuel by using buses and cars less, and walking more. In the medium and long-term alternatives *are* available, and the government should press on with discussions about the proposed hydro-power plant for Honiara, while supporting efforts to develop our infant bio-diesel industry in Solomon Islands and exploring the possibility of expanding solar panels to meet some of our household needs.

Finally, it is also important to note the profound effect that government spending can have on generating inflation and damaging the country's external reserves. Where development spending and RCDF funds are spent on consumable items in Solomon Islands this directly feeds into domestic inflation while flows overseas through purchase of imports contributes to the depletion of foreign reserves. Using development funds to make capital investments in infrastructure, in education or in health will help to limit the inflationary effect of government expenditure.

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