

AN OVERVIEW OF RECENT ECONOMIC PERFORMANCE AND PROSPECTS FOR THE SOLOMON ISLANDS ECONOMY

**[Presentation by Deputy Governor at the Development Partners Meeting, June 2,
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Introduction

Honorable Prime Minister, Mr. Bartholomew Ulufa'alu, Minister of Finance, Mr. Alpha Kimata, Minister of Development Planning, Mr. Fred Fono, Ministers of the Crown, Members of Parliament, Members of the Diplomatic Corps, Distinguished Representatives of Solomon Islands major Development Partners, Senior Government Officials, Ladies and Gentlemen.

This morning I will briefly describe recent developments in the Solomon Islands economy especially in relation to the governments reform program. I find it very useful do this by looking at graphs and diagrams that show trend movements clearly but given the time constraint we have, I will simply read from this note I prepared.

I will review developments in the main aggregates since the end of 1997 [before the reforms] and up to the first 5 months of 1999; [some 16 months since the start of the reform program].

At the end of this presentation, I will touch on some prospects for economic growth in Solomon Islands.

Background

As most of us here are aware, the government came in when the economy was grappling with a deteriorating and unstable international financial environment and an equally precarious and weak domestic situation. Since mid-1997 and for most of 1998, the global economy [especially the Asian region]

remained weak. The economic downturn in the Asian economies had a direct impact on Solomon Islands in terms of demand for Solomon Islands exports particularly log exports to Japan and South Korea. It was only in recent months that signs of improving conditions are emerging with more optimism that the crisis in Asia has bottomed out and these economies are on the path to economic recovery.

In order to deal with the developments in the external environment and address internal imbalances the government formulated and implemented a Policy and Structural Reform Program aimed at achieving macro-economic stability. Key policy measures introduced since 1997 include:

- adjustments to the exchange rate [20% devaluation in December 1997 & 6% in August 1998];
- pursued tight fiscal and monetary policies;
- pursuance of a wage moderation policy;
- public service reform;
- privatization and reform of state-owned enterprises and joint venture companies; and
- more consultation between the government and other stakeholders in the economy.

These policy measures helped to avert a potential crisis in the balance of payments and government finances.

It is against this backdrop that the recent developments in the Solomon Islands economy should be assessed.

Recent Economic Performance

Now I like to look at the recent developments in the Solomon Islands economy since 1997.

[The following table highlights developments in the main macro-economic and financial aggregates since the end of 1996. The latest figures for 1999 are as at the end April or May. Projections are also provided for 1999.]

Real Sector

Real GDP was estimated to have declined by 7% in 1998 compared with a growth of 3% in 1997. The fall in GDP reflects the decline in output in the forestry and agriculture sectors. Strong performance in the fisheries sector and the start of gold production late in 1998 partly offset this decline in GDP. A turn around in log production is expected for 1999 as log prices recover. Already log production for the first four months of 1999 is up on the same period last year and prices for logs have also improved. Gold export is poised to increase as the mine records its first full-year of production while other major export commodities are also expected to increase during the year.

Inflation rose to 12.3% in 1998 from 8.4% in the previous year, largely as a result of the [20%] devaluation at the end of 1997. The impact of this has now passed and inflation is expected to decline to pre-devaluation levels. Measures put in place by the government like the recently signed MOU between government and employer organizations to achieve wage and price moderation, and stability in the exchange rate should help ease the pressure on domestic prices.

At the end of April 1999, the inflation rate was 8.8%. This is lower than the previous year and represents a positive development, but inflation is still high compared to Solomon Islands main trading partners and could still continue to exert pressure on the exchange rate and interest rates. _

Balance of Payments

The balance of payments recorded an overall surplus of \$83 million in 1998 attributed largely to official capital inflows. As

a result of the surplus outturn in the BOP, the external reserves increased by 40% to \$233 million [about 3 months of import cover] at the end of 1998. During the first five months of 1999, the reserves have been maintained around the \$245-\$250 million mark. At the end of May 1999, the external reserves rose to \$251 million. Weak domestic demand resulted in subdued demand for imports. Import payments fell by 32% during the first quarter of 1999 while export receipts fell by a modest 7% over this period largely resulting from a decline in fish exports. Capital inflows from bilateral and multilateral sources [in support of the government's reform efforts] are expected to remain high in 1999 and together with an expected strong performance in the export sector another BOP surplus is envisaged for 1999.

Government Finance

Government finances improved and recorded a surplus in 1998. Revenue collections from both Inland Revenue and Customs Divisions during the first four months of 1999 exceeded budget projections. Similarly, expenditure over the same period has been below budget. This we believe are the direct result of the measures introduced to enhance revenue collection and tax administration and measures to control expenditures.

Debt servicing of government loans and arrears are on track. With the proceeds of the ADB loan received in 1998, all [except two] external debt arrears have been cleared. The expected inflows from official sources and privatization proceeds will be used to pay off all other government arrears and by the end of this year all domestic arrears should be cleared. The government is giving priority to debt servicing and has made the commitment to no net borrowing from the financial system in 1999.

A **debt-restructuring** exercise involving the conversion of some \$200 million of inactive Treasury Bills into long-term Bonds was agreed to in April 1999 with the governments main

domestic creditors. In order to revive the domestic securities market and restore investor confidence in government securities, an auction process was introduced for Treasury Bills, which allowed the market to determine interest rates. The first two auctions were a huge success with yesterday's auction substantially over subscribed and the Central Bank had to reject nearly \$20 million worth of bids. The outcome of the next few issues will have important implications on the overall interest rate structure.

Monetary Sector

Monetary developments in 1998 were characterized by a slight decline in credit, modest growth in broad money and a highly liquid financial system. These trends continued in the first five months of 1999, except for broad money, which surged in the same period.

Total **domestic credit** declined by 3.6% in 1998 reversing the 3.4% rise in the previous year. This fall was attributed to the decline in net credit to government [due to the increase in government deposits], which negated the 25% rise in credit to the private sector. This trend continued in the first five months of 1999 with credit to government falling by nearly 9% while credit to the private sector rose by 16%.

Money supply reported a modest 5% growth in 1998 compared to 6% in 1997. In the period to end May 1999, broad money grew by 21%, the growth coming mainly in demand and time deposits.

Free liquidity in the banking system remained high throughout 1998 and continued into 1999 reflecting the favorable balance of payments out turn and the growth in deposits.

Monetary policy was kept tight throughout 1998. The principle instrument used was the Bokolo Bill. Since the start of the auction system, these are being gradually phased out, as Treasury Bills become the main instruments of monetary

policy. This will allow the Central Bank to rely more on indirect instruments to implement monetary policy and liquidity management.

Prospects

I think the prospects for the Solomon Islands economy are favorable in the medium to long term. With recovery in the global economy, proper management of domestic resource endowments, together with appropriate macro-economic policies, and a stable law and order environment, economic growth is achievable in Solomon Islands.

Prospects for the short term are:

- Real GDP for 1999 is projected to grow by 2%-3%. This growth is expected to come from higher output and prices for the major export commodities and public sector investment.
- Inflation is expected to decline to pre-devaluation levels. That is still high compared to our major trading partners and the objective is to bring this down to 5%-6%.
- The balance of payments is expected to generate another surplus in 1999. This will come from an improved trade account and lumpy flows of official capital.
- As a result the external reserves is expected to increase further in 1999. The need to build the reserves to around 5 months [or more] of import cover will be a focus for policy in 1999. This is not only important for facilitating BOP transactions but also for instilling confidence in the economy; a very vital requisite for attracting investment into Solomon Islands.
- All government debt arrears to be cleared shortly. By the end of this year all arrears should be cleared and the government will be kept current with all its debt obligations.

Conclusion

I have described some of the recent developments in the economy and the prospects for the future. If I may look at the situation in a parabolic way, the state of the Solomon Islands economy is like a sick man slowly recovering from a long bout of illness. As he has spent several months lying in hospital naturally, he is still weak and unable to walk properly. But after some weeks he should get back his strength. He may still need to take some medication and regularly visit his doctor but after a while he should be strong and healthy and be able to do other things instead of worrying about his health.

I believe this is a very good description of the current state of the Solomon Islands economy.

Ladies and gentlemen, thank you for listening.

SI FINANCIAL INDICATORS: YEAR ON YEAR GROWTH (%)

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999#</u>
Real GDP 1/	3.5	3.0	-7.0	2-3
Inflation	9.2	8.4	12.3	8.8
External Reserves	122.0	29.0	55.2	40.0
Domestic credit:(TDC)	1.9	3.4	-3.6	1.8
to government (net)	-0.4	0.3	-21.5	-8.6
to private sector	6.2	8.5	25.2	15.9
Money Supply:				
Narrow money	16.8	6.6	4.4	23.3
Broad money	15.7	6.3	4.8	20.8
Free Liquidity 2/	81.4	-45.8	137.9	294.4
Interest Rates:				
Average deposit rate	4.76	1.84	4.36	3.17
Average lending	16.39	14.54	14.13	14.09

rate

**External Trade
(FET):**

Exports	9.0	-1.2	17.4	-7.1
Imports	-0.6	14.7	12.3	-32.2

**Government
Finance:**

Revenues	-6.5	-1.1	10.9	Na
Expenditures	Na	-6.6	-6.5	Na

Based on end May data

1/ Estimated for 1999.

2/ Defined as banks till cash plus call deposits with CBSI.