CENTRAL BANK OF SOLOMON ISLANDS

MONETARY POLICY STATEMENT
March 2019

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Table of Contents

1 Overview

Global growth slowed by 10 basis points in 2018 to 3.7%. This came on the back of sluggish results from Asia and the advanced economies, particularly the Euro Area. Saddled by the effects of the trade tensions and financial market tightening, the emerging market economies also decelerated by 10 basis points to 4.6%. Meanwhile, growth in the United States (US) picked up 70 basis points to 2.9% due to the sustained impact of the tax incentives. However, this stimulus is expected to dissipate in 2019, and US growth is projected to slow to 2.5%. Additionally, the weaker prospects for 2019 will see growth in advanced countries to fall to 2.3%, along with the emerging markets that will ease to 4.5%[1].

With respect to the country's key trading partners, China's growth eased to 6.6% in 2018 as the economy gradually moderates. This is expected to further decelerate to 6.2% in 2019 due to the effects of the trade war and the tighter financial sector regulations[1]. On the other hand, New Zealand's economy gathered pace in 2018 to 3.1% due to stronger labour conditions and a fiscal stimulus[2]. While in Australia a surge in exports and government spending helped Australia's economy to expand by 2.8% in 2018[3]. In 2019, Australia and New Zealand are both expected to grow by around 3% and 2.8% respectively [2, 3].

Global commodity price developments trended upward through most of the year before slowing down toward the end of 2018. On an annual basis, nonfuel commodity prices inched up 2%, and tapis oil prices increased by 11% as supply-side geo-political tensions limited stocks. Moreover, global inflation rose during the year with headline inflation rising by 30 basis points to 2% in advanced economies and by 60 basis points to 4.9% in the emerging markets. Nevertheless, the outlook for the global oil and commodity prices in 2019 is for projected moderate falls, which would also lead to an easing of global inflation[1].

The Solomon Islands economy registered a firm 3.9% growth in 2018, 0.4 percentage points higher than anticipated in the September 2018 Monetary Policy Stance. This positive development reflected heightened output from palm oil, cocoa and logs in the first six months of the year. Moreover, activity from fisheries, manufacturing, construction and wholesale-retail further drove the developments in the last half of 2018. On an annual basis, overall growth was influenced by the rise in the wholesale retail, transport, forestry, fisheries, manufacturing and construction industries.

Monetary conditions remained buoyant with reserve money rising by 8% and broad money by another 3%. The growth in net foreign assets by 2% and a much slower 1% growth in credit to the private sector contributed to the outturns. During the period, most credit growth went to the wholesale retail, professional services and construction.

External conditions meanwhile deteriorated in the July to December period of 2018. The current account surplus turned, influenced by the fall in goods after the earlier surge in the first six months of the year. Similarly, the capital and financial account surplus narrowed as foreign investment flows tumbled. The overall balance of payments surplus, therefore, slid to $46 million from $479 million in the previous period.

Associated with the weaker external sector, the Solomon Islands dollar depreciated against the United States dollar and ultimately weakened against the Trade Weighted Index TWI currency basket by 3%. With respect to trade competitiveness, the SBD appreciated 2% against the Real Effective Exchange Rate that reflected the high inflation differentials in the country.

During the last six months of the year, the implementation of the government budget saw a turnaround in the fiscal position to a deficit of $96 million as expenditure soared despite a rise in revenue. Nonetheless, on an annual basis, the fiscal position recorded a surplus of $191 million. This positive annual outturn represented the low spending in the first half of the year associated with the delay in passage of the 2018 Appropriation Act.

Inflationary developments picked up in the last six months of 2018 and capped off at 4.2% in December. While imported inflation grew

[1] IMF World Economic Outlook update January 2019.

[2] RBNZ Monetary Policy Statement February 2019.

[3] RBA Statement on Monetary Policy February 2019.

moderately to 1.7%, domestic inflation surged to 5.4%. Driving the growth in headline inflation was the fuel-associated transport, food, and, the alcohol and tobacco category related to betel nut. Meanwhile, core inflation remained stationary around 0.8% during the six months and implying that volatile items drove headline inflation during the period.

Looking ahead, the Solomon Islands economy is projected to grow by 3.7% in 2019. This slower growth reflects the curtailing of forestry output as part of the government's sustainability measures. Nonetheless, growth drivers for the year will come from wholesale retail, transport, construction, mining, manufacturing, and fisheries. Over the medium term, economic growth is expected to average 4.5% as constructions of major infrastructure projects ramp up, and key mining activities come online. However, downside risks to the outlook include spillovers of slower global demand, shocks related to natural disasters and the rapid depletion of forestry resources.

2 International Economic Developments

Global economic growth decelerated by 10 basis points to 3.7% in 2018 as anticipated in the IMF's October WEO forecast. Supporting the global growth, was firm expansion in the United States resulting from the ongoing fiscal stimulus and strong employment. Nevertheless, global growth projections for 2019 and 2020 were revised down by 20 basis points and 10 basis points to 3.5% and 3.6% respectively. The downgrade was due in part of the negative effects of the increase in trade tariff between the United States and China. This growth pattern reflected, higher than anticipated decline in growth from advanced economies and the temporary decline in growth rates coming from the emerging economies[4].

Growth in the advanced economies was previously projected to be above trend of 2.4%; however, this is revised downward by 10 basis points to 2.3% on the back of downward revisions for the euro area, coming particularly from Germany and Italy. Nevertheless, growth in the United States was broadly in line with the previous update recording 2.9% for 2018 before slowing down to 2.5% in 2019 and 1.8% in 2020, due to unwinding of the fiscal stimulus. As for the euro area, growth was revised down by 20 basis points and 30 basis points to 1.8% in 2018 and 1.6% in 2019. While growth in the United Kingdom slid 40 basis points to 1.8% in 2018 before slighting improving to 1.9% in 2019. This reflected the offsetting impact of the prolonged uncertainty on Brexit and the fiscal stimulus announced in the 2019 budget.[4]

Growth in the emerging and developing economies is expected to moderate, 0.1 percentage point lower than previously forecast to 4.6% in 2018 and 4.5% in 2019 before reverting to 4.9% in 2020. The expected dip stemmed from the wanned prospectus coming from the Chinese and Indian economies. Growth in China moderated to 6.6% due to the combined influence of financial regulatory tightening and the trade tension with the United States. It is projected to fall to 6.2% in 2019 and 2020. In India, crude steel production had remained high in 2018, despite easing growth of 7.3% for 2018. Growth is expected to pick up in 2019 to 7.5% and further increase to 7.7% a year after. The improved outlook for India provides positive prospects for the Solomon Islands in the face of the slowdown in China.[4]

Growth in our neighbouring trading partners gathered pace during the period. Despite a slowdown in the September quarter, the Australian economy registered an annual growth of 2.8% in 2018 reflecting higher net exports and public spending that offset slowdowns in household consumptions and house prices. By 2019, growth is projected to rise to 3% due to the positive impact of an accommodative monetary policy[5]. Likewise, growth in New Zealand improved at a solid pace at 3.1% in 2018 on the back of strong labour market, low interest rates and high government spending on infrastructure. However, growth for 2019 is expected to slow down to 2.8% before picking up again to 2.9% in 2020 in line with other trading partners' growth path[6].

2.1 International Commodity Prices

Based on World Bank data, commodity prices continued to improve in 2018. The price index for

[4] IMF World Economic Outlook update January.

[5] RBA Statement on Monetary Policy February 2019.

[6] RBNZ Monetary Policy Statement February 2019.

energy surged by 28% following a 24% increase a year ago to 87 index points. Similarly, non-energy price index grew by 2% to 85 index points, continuing the 6% increase recorded a year ago. Meanwhile, agriculture and food prices remained unchanged at 86 points and 90 basis points respectively. Crude oil prices remained volatile reflecting US policy influence on Iranian oil exports, recorded around USD$55 per barrel and is expected hover around that mark in the next 4-5 years. Meanwhile, the tapis oil, the proxy for Solomon Islands' oil imports, continued to firm in 2018, rising by 11% to USD$73 per barrel following a 44% surge in 2017. In contrast, the average price for beverages remained subdued, falling by 5% to 79 index points, following a 9% fall a year ago[7].

2.2 Global Inflation

Global inflation had remained relatively contained in recent months leading to year-end 2018. Although this was higher by 0.3 percentage points against 2017, mainly due to the US economy being above trend. During the year, headline inflation in advanced economies inched up by 30 basis points to 2% and in emerging markets by 0.6 percentage points to 4.9%. Core inflation also increased in some economies such as Canada, Norway, Sweden and the United Kingdom to be broadly around their targets, whilst core inflation was lower than target in some advanced economies. In the near to medium term, inflation expectations remain well anchored and stable despite signs of pickups[8].

On the regional front, headline inflation in Australia declined slightly to 1.9% from 2% in the previous year with core inflation of 1.8% broadly below target. These reflected spare capacity in the economy associated with low childcare cost, gas, electricity and new dwelling costs[9]. In New Zealand, inflation remained below the target of 2% although large increases in petrol prices seen over the second half of 2018 have now reversed. Inflation is likely to be still below target in 2019, despite rising cost of business on the back of strong competition[10].

3 Domestic Economic Developments

3.1 Monetary Conditions

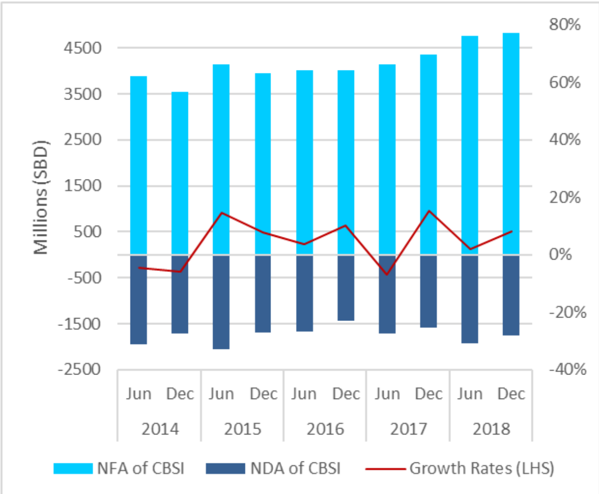
Monetary conditions remained supportive of economic activities throughout the last six months of 2018. Reserve money (M0) growth accelerated, narrow money (M1) growth eased whilst the pace of broad money (M3) growth remained the same as in the first six months of 2018. Meanwhile, liquidity continued to increase amidst muted private sector growth.

3.1.1 Reserve Money

Reserve money growth gained momentum in the second half of 2018, accelerating by 8% to $3,070 million compared to the slower growth of 2% posted in the first six months. The growth against June 2018 stemmed from increases in both Other Depository Corporations' (ODCs) call accounts and currency in circulation; the former by 9% to $2,158 million and the latter by 7% to $908 million.

On the asset side, gains in Net Foreign Assets (NFAs) by 2% to $4,834 million together with a reduction in CBSI's net domestic assets (NDA) by 8% to minus $ 1,758 million supported the firmer growth. The decline in NDA mirrored a fall in net domestic credit (NDC) by 11% to minus $1,763 million along with an upsurge in capital accounts from $84 million in June 2018 to $130 million.

Figure 1: Drivers of Reserve Money



Source: CBSI

[7] World Bank Pink sheet, Mar 2019 and Price forecasts, Oct 2018.
[8] IMF World Economic Outlook, Oct 2018 & Jan 2019 update.
[9] RBA Statement on Monetary Policy February 2019
[10] RBNZ Monetary Policy Statement February 2019.

3.1.2 Money Supply

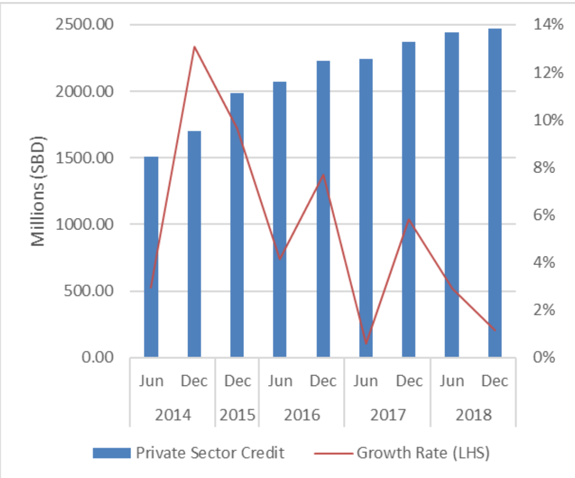
Broad money (M3) growth remained at 3%, the same as in the first half of 2018. M3 rose to $5,243 million against June 2018 driven increases in both narrow money (M1) and other deposits by 1% to $3,936 million and 12% to $1,307 million respectively.

On the sources of M3 growth, growth in both NDA and NFA supported the increase over the last six months. NFA expanded by 2% to $5,052 million driven by growth in foreign reserves. NDA surged by 45% to $240 million following a 20% growth in NDC to $1,215 million during the period. Meanwhile, capital accounts rose by 8% to $1,155 against the first six months of 2018.

3.1.3 Credit Conditions

Private Sector Credit (PSC) growth eased to 1% in the second half of 2018 compared to the 3% growth in the previous period. The marginal growth in PSC to $2,469 million was sustained by a 1% uptick in ODC lending to $2,460 million. The largest sectors sustaining this included construction, distribution professional and other services, transport, and manufacturing. On the other hand, credit extended to personal, communication and the tourism sector declined over the review period.

Figure 2: Credit to Private Sector

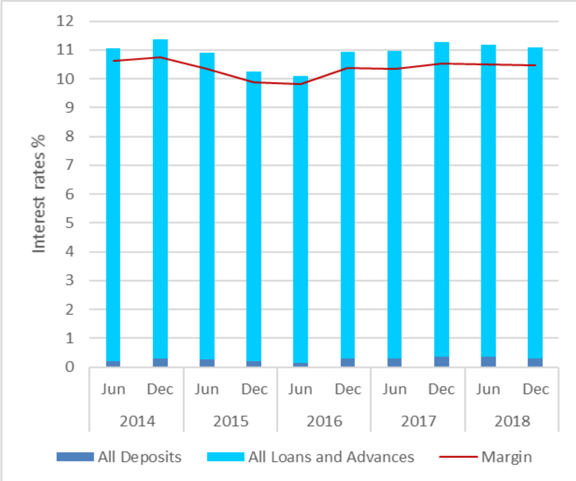


Source: CBSI

3.1.4 Interest Rate Trends

The interest rate margin narrowed to 10.48% in the second half of 2018 from 10.49% in the six months prior. Twin declines in the indicative weighted average interest rates on loans and deposits underpinned this outcome. Lending rates edged lower to 10.79% from 10.84% whilst the deposit rates shrunk to 0.30% from 0.35% in the first half of 2018. Broad-based reductions in interest rates across the major sectors underpinned the fall in interest rates.

Figure 3: Interest rate trends

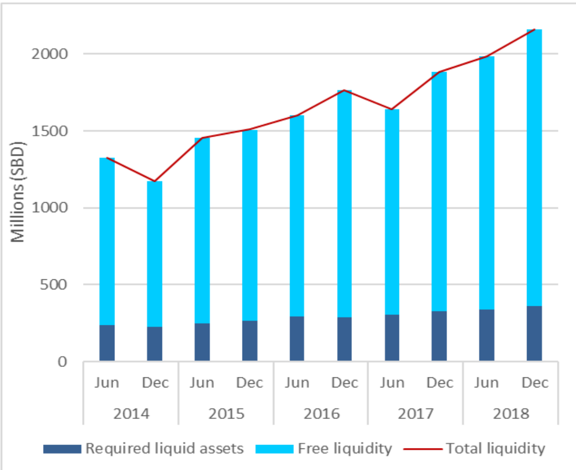


Source: CBSI

3.1.5 Liquidity Levels

Liquidity levels in the banking system continued to rise throughout the last six months of 2018, with excess liquidity increasing further by 10% to $1,610 million. CBSI's net foreign assets remained to be the key driver of liquidity growth along with the drawdown of government deposits observed in the latter half of 2018.

Figure 4: Liquidity levels



Source: CBSI

The stock of Bokolo Bills floated by CBSI remain capped at $750 million at end December 2018 with the interest rate remained unchanged at 0.62%. On the other hand, the government has progressively increased the treasury bills' threshold from $40 million to $100 million. Furthermore, the 56 days maturity term was discontinued whilst a new maturity term of 365 days with a WAY of 2% was introduced. The WAY for 91 and 181 remained at 0.49% and 1.12% respectively by December 2018.

3.2 Domestic Conditions

Domestic economic activities strengthened in the second half of 2018 following upbeat movements across the fishing, wholesale and retail, energy, manufacturing, tourism and communication sectors over the period. On the other hand, a slow-down in log output was recorded in the second half of the year reversing the record high log output registered in the first half of 2018.

3.2.1 Economic Growth

Following the pickup in economic activities in 2018, economic growth has been revised upwards to 3.9%, 40 basis points higher than the 3.5% forecasted in the September 2018 MPS projection. Supporting this outcome were strong performances in the logging, fishing and palm oil industries coupled with the sustained growth in the construction, manufacturing, wholesale and retail and communication sectors during the year.

However, the growth outlook for 2019 has been revised slightly downwards to 3.7% from the 3.8% forecasted in September 2018 MPS. This is driven by the projected slower growth in the forestry sector as part of the government's sustainability initiative for the industry. Despite this outcome, the growth forecast for 2019 will be sustained by the pickup in economic activities across the services and secondary sectors. Disaggregating the overall growth forecast for 2019 by broad sectors, the services sector is projected to contribute 2.6% while industry and primary sectors are expected to contribute 0.9% and 0.7% respectively.[11]

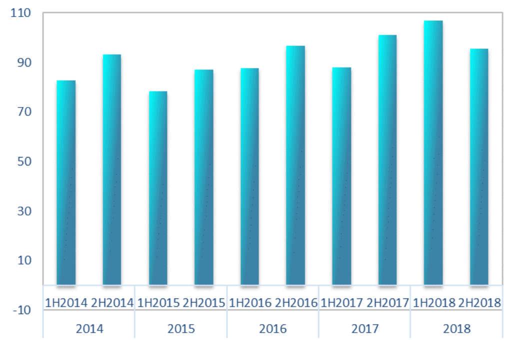
3.2.2 Production Index

Domestic production activities slowed in the second half of 2018 with the CBSI production index contracting by 11% to 95 points and reversing the 6% growth recorded in June 2018.

Underpinning the outcome were weaker production outcomes. Log output declined by 14% to 1.3 million cubic metres, crude palm oil fell by 20% to 16,898 metric tons and palm kernel oil output contracted by 19% to 1,749 metric tons over the reviewed period. Similarly, subdued performances were recorded for copra and cocoa output due to weak global market prices and poor yields during the period.

On the other hand, fish catch strengthened further, increasing by 4% to 19,823 tons backed by the full operation of its two Long Liner Vessels in the second quarter of the year.

Figure 5: Half Yearly Production Index

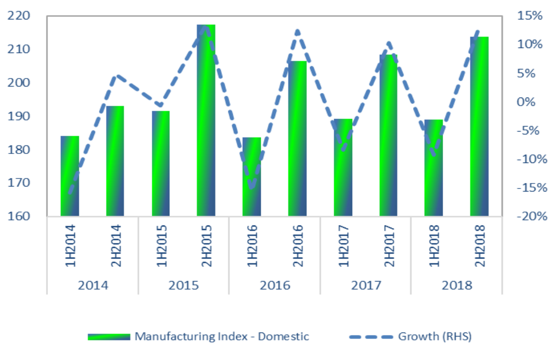


Source: CBSI

3.2.3 Manufacturing

Manufacturing activities gained momentum in the second half of the year, rising by 11% to an average of 320 points. The CBSI manufacturing index for goods destined for the domestic market, as a proxy for domestic demand picked up by 13% to 214 points. This outcome was attributed to the growth in alcohol and soft drinks and canned tuna production rising by 21% each and biscuits picking up slightly by 1%.

Figure 6: Manufacturing Index Trend



Source: CBSI

[11] Statistical balancing and Imputed items account for -0.5%.

Similarly, goods destined for export market improved further by 10% to 545 points reflecting sustained demand for the country's tuna products in the overseas market. Meanwhile, loans to the manufacturing sector fell by 8% to $149 million by the end of December 2018 although 7% higher than the corresponding period in 2017.

3.2.4 Employment

The number of Solomon Islands National Provident Fund (SINPF) contributors, a proxy for labour market conditions, showed improvements during the second half of 2018. The average number of slow and active contributors increased by 4% to 58,736. This outcome was driven by the pickup in the number of active contributors over the period by 5% to 52,018 members.

3.2.5 Other Sectors

Other economic sectors generally recorded positive outcomes during the second half of 2018, although the transport sector showed mixed movements during the period.

The total number of foreign investment applications as a proxy for Foreign Direct Investment (FDI) picked up by 9% to 106 applications during the second half of 2018 with a majority of the applications received for wholesale retail followed by other services such as consultancies. Similarly, proxies for the wholesale retail sector remained vibrant with lending to the sector growing by 5% to $487 million, employment rising by 11%, along with the sector's continued dominance in FDI applications during the period.

The construction sector continued to expand with total approved building permits registering a 10% increase to 178 permits. Likewise, the value of building permits surged by 25% to $255 million. Meanwhile, electricity generation rebounded in the second half of the year to increase by 5% to 49,552 Megawatt hours (MWh). Total units sold also grew by 3% to 39,088 MWh, in particular sales to the government sector.

Similarly, partial indicators used to measure performance in the communications sector recorded a 14% growth in mobile usage and an 11% increase in internet usage which outweighed the 2% decline in fixed lines over the period. Moreover, total visitor arrivals rebounded to grow by 9% to 14,549 arrivals in the second half of the year reversing the 8% decline previous period. This outcome was driven by a 9% increase in air arrivals reflecting the hosting of the Melanesian Arts Cultural Festival in Honiara in July 2018.

In contrast, lending to the transport sector slowed down by 9% to $149 million. On the other hand, newly registered vehicles grew slightly by 2% to 1,402 vehicles while employment in this sector increased by 4% to 1,858 employees during the period.

3.3 External Conditions

The Balance of Payments (BOP) position contracted in the six months to December 2018 to a surplus of $96 million compared to $479 million in the previous period. This was due to the current account sliding into deficit territory and the narrowing of the capital and financial account surplus. Nonetheless, on an annual basis, the BOP position benefited from a robust first half-year result, registering a surplus 5% of GDP for 2018 against a surplus 2% of GDP for 2017. As a result, the gross foreign reserves grew by 10% year on year to $4,984 million in December 2018.

3.3.1 Current Accounts

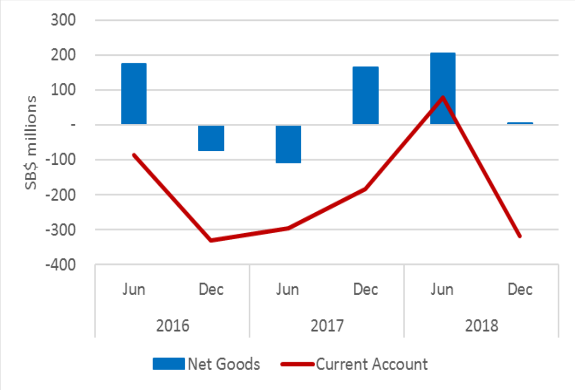
The current account turned around from a surplus of $79 million in the first half of the year to a deficit of $506 million in the six months to December. This outturn came from the reduction in goods and secondary income, along with an expansion of services and primary income.

During the reference period, the trade in goods reversed to a deficit of $183 million after the significant $205 million surplus in the previous six months. This primarily came from a 20% jump in imports to $2,308 million, particularly from machines, food and basic manufactured goods.

Additionally, exports slightly fell by 0.1% to $2,125 million and reflected the downturn in logs, palm oil, minerals, copra and cocoa. On the other hand, palm oil, fish and other exports rose during the period.

Additionally, all other categories weakened during the period. The services deficit particularly from transport deteriorated by 37% to $348 million, and the deficit in primary income widened from $29 million to $59 million as the country received less fishing licence revenues. The surplus in secondary income also declined from $157 million to $82 million due to lower donor cash grants and higher personal transfers.

Figure 7: Trade and Current Account Balances



Source: CBSI

3.3.2 Capital and Financial Account

The surplus in the 'capital and financial' account more halved to $146 million during the reference period. This was influenced by the deterioration in the financial account from net inflows of $124 million to net outflows of $117 million in the second half of the year. Moreover, a reduction in foreign direct investment flows contributed to the negative financial account position.

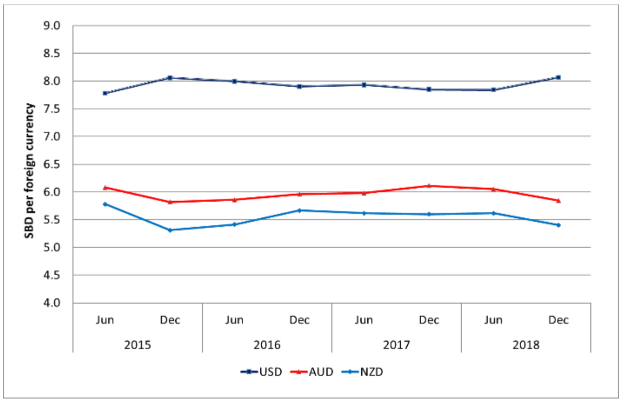
On the other hand, the capital account surplus improved by 21% to $262 million on account of the completion of a variety of major donor-funded capital projects during the period.

3.3.3 Exchange Rate

The weaker external conditions in the second half of the year are evident in the 3% fall in the Solomon Islands dollar (SBD) against the Trade Weighted Index to an average 109.3 points. This movement in the invoice-weighted basket of trading currencies also reflects the 3% depreciation of the SBD against the USD to an average $8.07 per USD for the six-month period. On the other hand, the SBD appreciated against all the other major currencies including both the Australian and New Zealand dollars by 4% each to $6.05 per AUD and $5.40 per NZD respectively.

Meanwhile, the Real Effective Exchange Rate (REER) strengthened by 2% to an average index of 150.3 during the six months to December. Despite the apparent nominal depreciation in the currency, the REER outturn reflects the higher inflation in the Solomon Islands compared to its trading partners. It also suggests that the country's exports were less competitive during the period under review.

Figure 8: Nominal Bilateral Exchange Rates

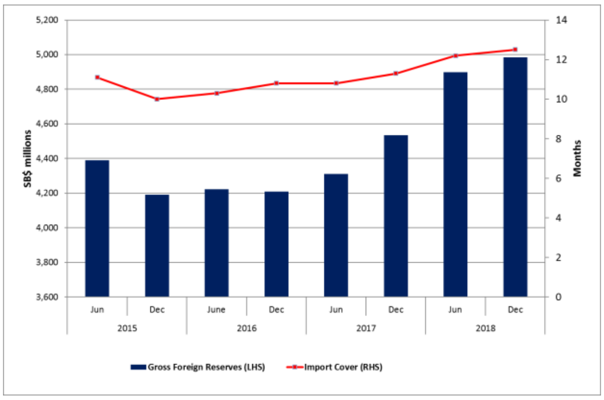


Source: CBSI

3.3.4 Reserves

The gross foreign reserves only rose by 2% to $4,984 million in December 2018. This compares to a more robust 8% growth in the first six months of the year. Inflows of donor grants, exports receipts and foreign exchange revaluation gains contributed to the result during the review period. On an annual basis, this level of reserves was up 10% against December 2017 and is equivalent to more than 12.5 months of import cover.

Figure 9: Gross Foreign Reserves

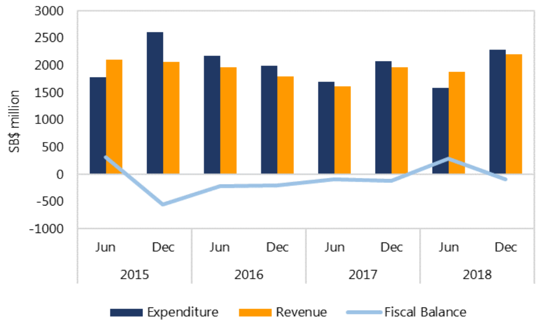


Source: CBSI

3.4 Fiscal Conditions

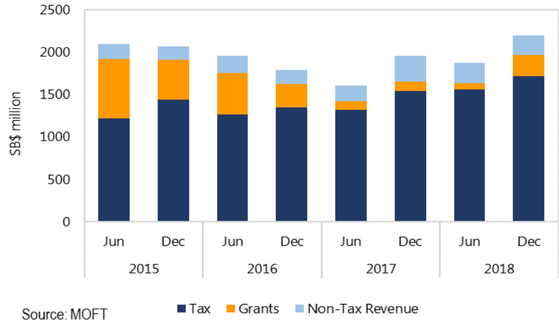
The government fiscal balance worsened during the second half of 2018. The government recorded a deficit of $96 million, overturning a revised surplus of $288 million in the first six months of the year. This negative outcome was driven by a notable increase in total expenditures, which exceeded the growth in total revenue collected over the period. Meanwhile, the government debt position grew further during the six months to December 2018.

Figure 10: Fiscal Balance



Source: MOFT

Figure 11: Fiscal Revenue Collection



Source: MOFT

3.4.1 Revenue

Total government revenue collected rose by 17% to $2,194 million in the months of July to December 2018 and outperformed the budget by 13%. The increase in overall revenue collection against the previous six months of 2018 reflected improvements in tax revenue and grant aids received during the period. Against the same period in 2017, total revenue collection was 12% higher.

Tax revenue grew by 11% to $1,722 million during the reference period. This positive outcome resulted from the increases across all tax categories related to the boom in trade and better compliance. Tax on international trade and transactions rose by 1% to $547 million, and Tax on income and profits edged up by 11% to $545 million. Similarly, tax on goods and services surged by 28% to $387 million, whilst tax on property went up by 17% to $23 million over the period.

Grants received from donor partners grew markedly during the second half of 2018 to $242 million compared to $75 million in the prior period. Non-tax revenue, on the other hand, fell by 4% to $231 million. The reduction in non-tax revenue was primarily attributed to low proceeds from fishing licenses during the period.

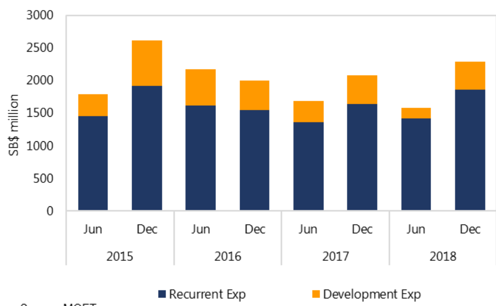
In terms of share, tax revenue accounted for 78% of total revenue collection, whilst non-tax and grant receipts both represented 11% each during the referenced period.

3.4.2 Expenditure

Total government outlays soared by 44% to $2,291 million in the six months to December 2018, emanating from higher spending on both recurrent and development expenditures during the review period. This was consistent with the trending effects where government spending normally picks up in the second half of the year. Compared to the corresponding period in 2017, government expenditure was higher by 10% but fell below the half-yearly budget by 1%.

Recurrent expenditure, which accounted for 81% of total spending, grew significantly by 31% to $1,858 million. This outcome came mainly from the 65% surge in consumption spending on goods and services to $884 million, coupled with a 6% growth in payroll to $678 million during the period. The increased spending on social benefits and other expenses also contributed to this outcome.

Figure 12: Fiscal Expenditure



Source: MOFT

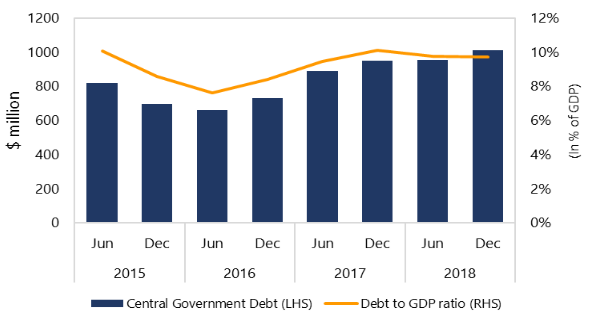
Capital spending, which represents 19% of total government expenditures, more than doubled to $433 million during the second half of 2018. This was emanated from increased spending on major categories including buildings and structures, machinery and equipment, other fixed assets and government land purchase during the review period.

3.4.3 Public Debt Stock

Total Central Government outstanding debt stock increased by 6% to $1,012 million at the end of December 2018. This reflected the additional loan disbursements by multilateral creditors combined with the upturn in auction treasury bills issued during the review period. The foreign exchange rate movements also contributed to this outcome. Of the total debt balance, external debt amounted to 79% while domestic debt accounted for 21%. As a debt sustainability indicator, the debt-to-GDP ratio remained comfortably at 10% of GDP at the end of December 2018.

Meanwhile, total debt repayment dropped to $24 million compared to $30 million repaid over the previous period. By components, $20 million was for principal repayments, and $4 million was on interest payments.

Figure 13: Public Debt Trends



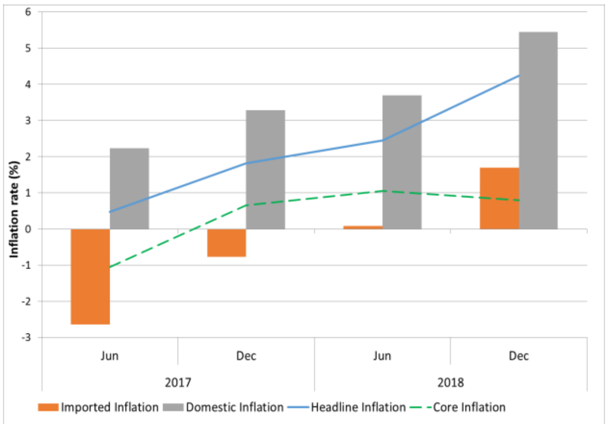
Source: CBSI/ MOFT

3.5 Inflation Developments

Inflationary pressures in the country picked up in the second half of 2018. Headline inflation rose to 4.2% at the end of December from 2.4% posted in June 2018. This reflected price increases in both domestic and imported inflation during the period. Also supporting this outcome was the introduction of the new Honiara Consumer Price Index (HCPI) Series 3 in July 2018 that led to changes to the HCPI, namely the inclusion of four additional, as well as segregated categories compared to the former HCPI series 2.

Domestic inflation surged from 3.4% to 5.4% at the end of December 2018. Driving this result were price increases in food and non-alcoholic beverages category which rose by 4.1 percentage points to 6% reflecting inflationary pressures coming from supply shortages of market produce particularly fish and seafood items driven by unfavourable weather patterns. Similarly, the alcoholic beverages, tobacco and narcotics category picked up by 7.6 percentage points to 14.4% due to price hikes in betel nut over the reviewed period. Meanwhile, all other categories eased over the first half of the year.

Figure 14: Inflation Developments



Source: NSO

Imported inflation also picked up to 1.7% from 0.1% in June 2018. The uptick in imported inflation reflected higher prices recorded across major categories of food and non-alcoholic beverages, transport, housing utilities and miscellaneous goods and services over the period. Transport surged by 8.8 percentage points to 13.6%, food improved by 40 basis points to minus 1.1%, housing utilities grew by 1.7 percentage points to 4.5% while miscellaneous component edged up by 30 basis points to minus 0.7%. These outweighed the price declines in furnishings and clothing and footwear categories whilst all other categories levelled off over the period.

In contrast, core inflation eased to 0.8% from 1.7% recorded in June 2018. This implies price declines coming from non-food and non-energy categories during the reviewed period.

4 Domestic Economic Outlook

Growth is projected to remain firm at 3.7% in 2019, although lower by 0.2 percentage points against the growth for 2018. This outlook is projected to be backed by fishing, mining, construction, communication, wholesale and retail, and transport and storage. All these sectors are anticipated to collectively offset the expected contraction in the forestry sector in the near to medium term.

Over the medium term, a robust output is expected on the back of large development project rollouts. The Gold Ridge Mining is anticipated to operate in full scale by 2020, along with the new submarine cable that is expected to boost internet services. Similarly, the Tina Hydro project with its major construction work as well as the upcoming South Pacific games is all expected to potentially support growth in the medium term.

However, there are downside risks to the forecast horizon as there is uncertainty revolving around the advancement of other productive sectors and fiscal developments that may weigh down on growth as the new government is formed after the national election on 3rd April.

Meanwhile, the outlook for the external sector in the near term is projected a widening of the current account deficit due to the rise in imports for the major construction and mining projects. Nonetheless, capital and financial inflows are anticipated, which is projected to result in a reduced BOP surplus and a slight build up in the foreign reserves.

Additionally, monetary conditions are expected to remain positive. Reserve money is projected to trend upward, while broad money will moderately grow, accompanied by slower credit growth. As such, excess liquidity will continue to rise over the forecast horizon.

While the caretaker government instituted a balanced budget of $3.93 billion for 2019 as part of its fiscal consolidation measures. CBSI's outlook projects a likely fiscal expansionary stance once a new government is formed after the April elections. Due to the rebuilding of the fiscal buffers during 2018, and timing constraints to fully implement its activities, a fiscal surplus balance is anticipated for 2019.

Finally, inflationary pressures had been on the high side of above 4% triggered by the increase in fuel prices towards the second half of 2018. While underlying inflation is expected to move between 1% - 3% over the medium term, headline inflation is anticipated to remain contained within an acceptable band of 3-5% over the forecast horizon. However, there is a heightened potential that headline inflation volatilities could push prices above this band in the near term. This is most pronounced with the increasing uncertainty and risks coming from international fuel and commodity prices, and supply shocks related to severe climatic conditions. Therefore, the moderate to high prospect for prices has lowered the spare capacity to accommodate any upward inflationary pressures.

5 Monetary Policy Stance

Given recent positive outturns in the macroeconomy during the prior year and prospects for higher inflationary pressures in the near term, the CBSI has resolved to adopt a moderate tightening monetary policy stance for the next six months. The shift from the previous accommodative stance reflects concerns about the potential for headline inflation to exceed expectations. Moreover, the Bank will consider taking appropriate measures should there be any large adverse macroeconomic shocks to the economy.