Foreign Reserves - Part Two:

By**,** CBSI Media

Welcome once again to our weekly feature from the Central Bank of Solomon Islands (CBSI). In our previous article, we looked at the definition of "Foreign Reserves," its importance, and how it affects the country and the economy as a whole.

In this article we will dig deeper and technical into foreign reserves. What factors drive the growth of our foreign reserves? What is the current level of our foreign reserves and what is CBSI doing with these foreign reserves?

We will also look at the global risks that could likely have an impact to our foreign reserves and may pose a direct threat to them.

SI Foreign Reserves Level Trend from 1999 to 2019

To begin, let's look at the "Solomon Islands Foreign Reserves Level Trend" from the year 1999 to 2019. Over the last two decades, our foreign reserves has grown dramatically on a yearly basis to a high record to this day. During the ethnic crises in the year 2000-2002, our foreign reserves were at the brink of depletion. This critical situation has called for tighter foreign exchange regulation control interventions to protect foreign reserves from capital flight. This involves rationing of foreign reserves outflows for specific and selected transactions only. This has sustained the economy during the period. Since then, our foreign reserves are hitting high records throughout the years till now. As of end of August 2019, our total foreign reserves amounted to approximately USD $587.0 million. This is equivalent to SI $4.8 billion. In terms of the Foreign Reserves Adequacy this is approximately 10.3 months of import cover (all payments and nonfactor services). The foreign reserves has reached an unprecedented level compared to USD50.0 million in 1999.

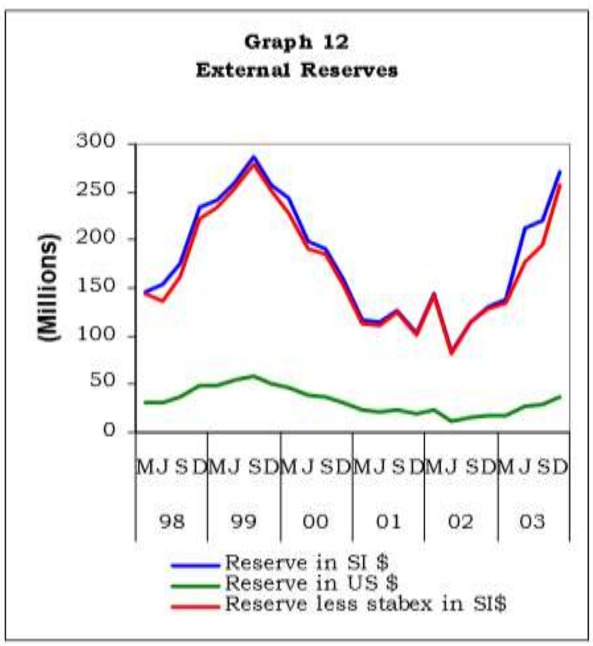
SI Foreign Reserves Level Trend from: 1998-2003:

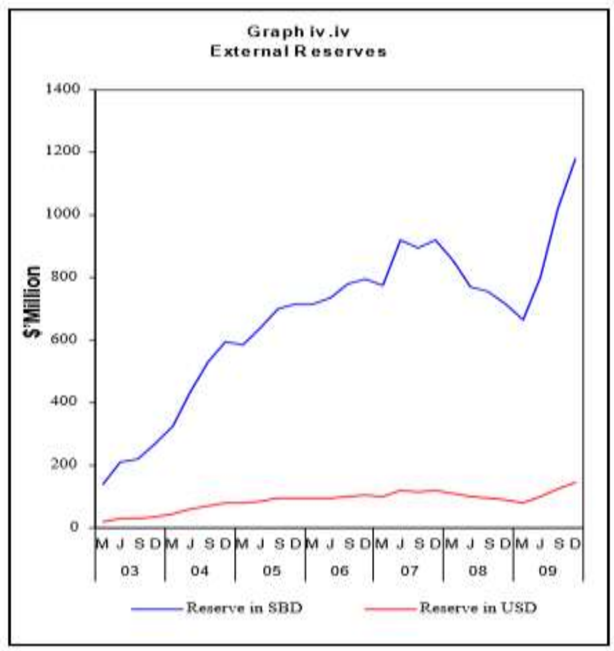
As one might reflect, the period between the years 1998 to 2003 were the darkest years in the modern history of our country. CBSI Annual Report 2003 Chart.1. shows our foreign reserves level was approximately less than SI$200 million which is equivalent to USD $40.0million.

In the year 2002, the foreign reserves dipped far below the foreign reserves adequacy level, declining to its lowest level, equivalent to only one month of import cover. At one stage between the years 2001 & 2002 it was equivalent to just around two weeks of import cover. Our foreign reserves level bounced back in late 2003 following the arrival of the Regional Assistance Mission to Solomon Island (RAMSI) which not only restored law and order but also boosted foreign investors' confidence and foreign aid inflows into the country.

Post RAMSI Intervention and SI Foreign Reserves Level Trend: 2004-2009

Immediately after the normalization of law and order, our foreign reserves level began to improve and increased to a staggering SI$1.15 billion, which is equivalent to US$145 million dollars. As shown on the record, from less than one month import in the year 2000 to approximately six months import cover in year 2009.



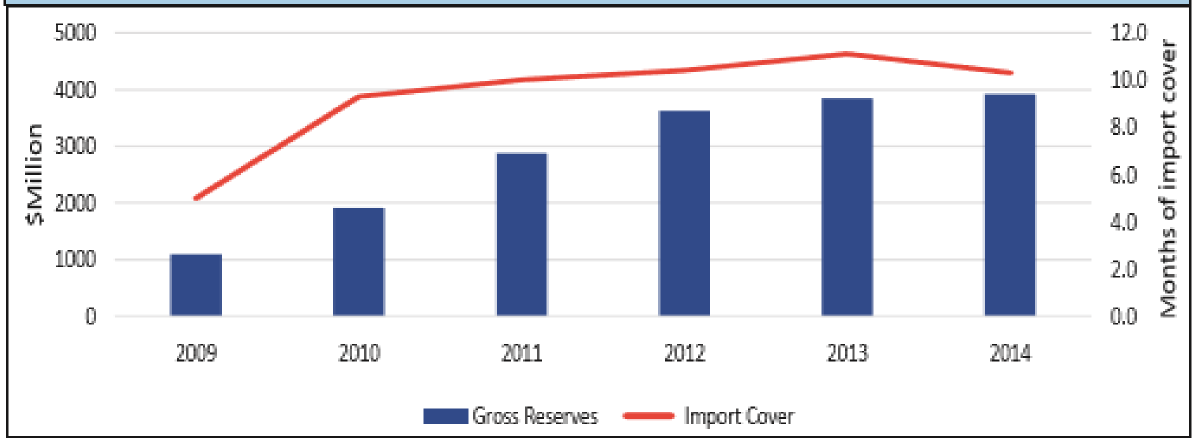


SI Foreign Reserve Level Trend - 2010 to 2014 (Chart 3)

From year 2010 and onwards, the country's foreign reserves level continued to grow over the period hitting high records every single year. This indicates a growing and developing nation. Chart 3 is an extract from CBSI 2014 Annual Report, which highlights this linear growth trend from year 2009 to 2014. Our foreign reserves rebounded further from SI$1.15 billion to a staggering SI$4.0 billion in 2014. In US

Dollar terms, it is an increase from US$145.0m in year 2009 to US$551.0 million in year 2014

Figure 4.1: Gross International Reserves (average) trend 2009-2014



Source: CBSI

SI Foreign Reserves Level Trend: 2014 -2019

Over the past five years our foreign reserves maintained its growth momentum. In the year 2018, the foreign reserves level has increased to SI$5.0 billion. This is approximately US$590.0 million, which puts the reserves adequacy level at equivalent to 10.5 months of import Cover.

GROSS FOREIGN ASSETS

Source: CBSI

Driving Factors of our Foreign Reserves

You may wonder what has driven our foreign reserves growth over the last two decades. There are numerous factors, but the fundamental drivers are our domestic economic environment including real sector growth, local investment activities and international trade, government policies and the global market conditions. During the post-ethnic crises, the government was able to forge renewed bilateral engagements with our international partners. Donor Funding poured into the country in terms of SIG budgetary support, public infrastructure projects, education and health. International Financial Institutions like the International Monetary Fund (IMF) also injected emergency credit facility for the country. Domestically, our export industry resurrected and picked up momentum. Such renewed support and boost in the economy was the driving force behind the growth of our foreign reserves. In essence, foreign reserves growth simply tells us that we are financially stable and our economy is slowly growing.

The Main Sources of Our Foreign Reserves?

Our main sources of foreign reserves include receipts from commodity exports, donor grants and external loans, Government receipts, capital inflows and personal transfers. For example, when you receive money from friends and family from overseas, these are sources of foreign currency, which adds to the foreign reserves basket. When the Government borrows overseas, we also receive foreign reserves. As the real sector continues to develop and grow, Solomon Islands export base broadens. At present, the country's exports comprise mostly of primary products. One of our major primary industry is forestry. Round logs has been the main driver and predominant source of our foreign reserves, comprising more than 60 percent of international foreign reserves received annually. The others are agricultural products such as palm oil, copra, cocoa, fisheries, and frozen tuna. Other secondary products are canned tuna, bottled and canned beer, and other small products. These exports are the core sources and drivers of our foreign reserves.

As the USD is recognised as the world's most preferred reserve currency, most international trades are domiciled in USD. Usually, the export receipt (either quoted in USD or another foreign currency) will be transferred from the overseas importer's bank to a local commercial bank. The local bank will then transfer the SBD equivalent to the exporter's account while the foreign currency is sold to the Central Bank.. The foreign currency sold to CBSI will be held in the foreign reserves basket and becomes our "Foreign Reserves" or part of our "Gross Foreign Reserves." This process is a requirement under the Exchange Control Act, which has the ultimate objectives of foreign reserves preservation and protection of our legal tender – Solomon Dollar. This simply means that we can only exchange in the local economy with the Solomon Dollar while we utilize the foreign reserves for exchange with residents of a country outside the Solomon Islands.

Global Market Risks That Could Affect Our Foreign Reserves

As foreign currencies are used for international trade, they are subjected to external global market conditions, hence, are vulnerable to external and systemic risks. In order to minimize these risks, the CBSI must ensure that foreign reserves are protected and managed accordingly under a Reserves management Policy framework. This Policy Framework includes the management of credit, currency and operational risks, which, are administered by the Foreign Reserves & Exchange Control Department of the CBSI.

What Do We Do With Our Foreign Reserves?

Holding money (or foreign reserves in this case), has a cost and the CBSI must be able to cover these costs. As such, the CBSI manages a portfolio comprised of the various instruments (as highlighted in article 1) and held with various approved external counterparties including Investment grade rated commercial and Investment banks, Foreign Government Treasuries and Reserve Banks. These holdings have minimal risks and generate reasonable interest returns to cover costs and CBSI operations.

As highlighted in our previous article, The CBSI Act 2012 stipulates that the CBSI will manage our foreign reserves with a goal to achieve the following. SAFE, LIQUIDITY and YIELD.

The words SAFE, LIQUIDITY and YIELD specified in the CBSI act 2012 forms the basis of the CBSI reserve management policy. This is a fundamental and technical policy document that outlines and guides our operational management and administration of our foreign reserves investments. The Reserves Management and Investment Unit of Financial Market and Exchange Control Department of CBSI is directly responsible for the management of our Foreign Reserves.

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