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GENERAL NOTE

p provisional

e estimate

- nil

n.a. not available

(i) The sum of the components may differ from the totals in some instances due to rounding.

(ii) Data are subject to periodic revision as more updated information becomes available.

GLOSSARY

The following terminologies are defined in the context of Solomon Islands.

Balance of Payments (BoP): Records all payments and receipts relating to the movement of funds between a country and foreign countries.

Bank Liquidity: Total amount of cash held by banks and not used for investment or other transactions.

Capital account: Records international transactions relating to the flow of capital between a country and foreign countries, such as investment, loans etc.

Current account: Records international transactions relating to the flow of goods, services, income and gifts. A surplus indicates higher inflows than outflows and a deficit indicates the opposite.

Domestic credit: Value of loans and advances obtained from within the country.

Excess Liquidity: The liquidity that banks possess that is greater than the minimum prescribed by the Central Bank.

Exchange rate: The price of foreign currencies stated in terms of the local currency or vice versa.

Exports: Goods that a country sells abroad.

External reserves: Stock of foreign currency assets of the Central Bank. These assets are earned through exports, foreign aid and loans obtained from institutions abroad.

Gross Domestic Product (GDP): Total value of all final goods and services produced in an economy during the course of a year.

Honiara Retail Price Index (HRPI): A consumer price index which shows the price level and changes in price level of goods and services in Honiara over time. This information forms the basis for calculating inflation in the economy.

Imports: Goods that a country buys from abroad.

Liquidity Asset Requirement: Usually defined as a percentage of deposit liabilities of a commercial bank that shall be held as cash or as balance with the Central Bank.

Money Supply: The total quantity of money in a country's economy at a particular time.

Narrow money: Notes and coins in the hands of the public plus money held on demand deposits at the other depository corporations and the Central Bank.

Net Credit to Government: Value of borrowings by Government less its deposits at the other depository corporations and the Central Bank.

Private sector credit: Value of borrowings by private companies and individuals within the country.

Other deposits: Total of time deposits and savings deposits.

Trade balance: The difference between merchandise exports (goods sold overseas) and merchandise imports (goods purchased from overseas).

Trade surplus/deficit: A trade surplus is when the value of exports is higher than the value of imports, whilst a trade deficit is when receipts from exports are less than payments for imports.

Chapter I. OVERVIEW AND ANALYSIS

The Solomon Islands economy slowed in 2019 with growth easing to 1.2% compared to 3.9% in 2018. This outcome was attributed to the falls in primary commodities, particularly agriculture and forestry, along with weaker fiscal activity and sluggish domestic demand that affected manufacturing and services. By sectoral growth, the primary sector dropped 6 percentage points to -1.3%, secondary slid 50 basis points to 4.9% and services declined by 70 basis points to 2.7%.

Contributing to the growth outturn in Solomon Islands was a sluggish global environment that saw global growth tapered to 2.9% in 2019 from 3.0% in the prior year. The effects and persistence of the US-China trade tensions, weaker trade and investment activities in both emerging and advanced economies, coupled with social unrest and weather-related shocks in some countries contributed to the outcome.

Moreover, the production of the country's primary commodities declined during the year. Aside from the positive growths in fish catch and cocoa, the other key products; logs, palm oil, copra and coconut oil all declined during the year. As such, the CBSI annual production index slid 6.8% to 98 points and reflects the soft demand for these products in overseas markets, and also the structural issues such as the future stock of harvestable logs and senile coconut plantations.

On the external front, the balance of payments likewise deteriorated to a deficit of \$292 million from the \$527 million surplus in 2018. This reversal emanated from the fall in exports and the surge in service payments that led to a large deficit in the current account. On the contra side and to partially finance this outturn, the capital and financial account increased during the year. The gross foreign reserves accordingly declined by 6% to \$4,706 million. Meanwhile, the Solomon Islands dollar depreciated against the United States Dollar but strengthened against the Australian and New Zealand dollars.

Reflecting the subdued economic environment, monetary conditions weakened. Reserve money, narrow money, broad money and liquidity all declined. Although bank lending still rose by 4% to \$2,425 million and was driven by growth coming from personal, transport, distribution and construction sectors. The weighted average interest rate margins also narrowed due to the fall in lending rates, and slight pick up in deposit rates.

Government's financial position turned negative in 2019 with a \$202 million deficit against a surplus of \$191 million in 2018. This turnaround reflected a small

fall in expenditure against a larger fall in revenue driven by the fall in exports and weaker business conditions for taxes. Meanwhile, government's debt level at end 2019 remained at a sustainable 11% of GDP.

Labour market conditions grew slowly in 2019. Proxy indicators from the Solomon Islands National Provident Fund show 'active and slow active' contributors only grew by 3% to 60,643. Moreover, filled public service establishment numbers slowed and newspaper job advertisements declined. On the other hand, short term contracted employment and seasonal labour work overseas increased during the period.

Consumer prices remained at acceptable levels in 2019. End period headline inflation for December 2019 was 2.8% compared to the 4.2% in December 2018. This was driven by the fall from both the import and domestic categories in food, fuel, 'clothing and footwear' and 'hotel and restaurants'. This offset price pick ups in 'alcohol and tobacco' related to betel nuts, and utilities. Meanwhile, annual average core inflation in 2019 remained at the same rate of 1.6% as in 2018.

With the onset of the coronavirus (Covid-19), the outlook for the Solomon Islands economy is quite unfavourable. Economic growth is projected to tilt downward to between -3% and -5% in 2020 and affect both the external and domestic environments. Sectors that are expected to drive the fall in growth are forestry, tourism, transport and manufacturing. Moreover, travel restrictions could mean the delay in national projects. Nonetheless, fisheries and palm oil, as intermediate goods for food products are projected to have the least negative impact, as their production would remain uninterrupted unless the pandemic were to affect workers at their respective sites.

The great uncertainty on the horizon from Covid-19 that has swamped the world means the Solomon Islands economy has been placed under considerable downside risk. To deal with the immediate issue of Covid-19, government must continue to support public health measures and with the assistance of other stakeholders ensure that workers and firms are not permanently laid off or closed down. In the aftermath of the crisis, the country should have in place a stimulus package to restart the economy. Moreover, the country must earnestly build up its resilience buffers, through rainy-day funds, institutional policy measures and a broader economic base to prepare the country to mitigate any future shocks and global recessions.

Chapter II. INTERNATIONAL DEVELOPMENTS

Global Output

According to the International Monetary Fund (IMF)¹, global growth in 2019 was downgraded further to 2.9% from 3.0% in the 2019 October World Economic Outlook (WEO). Underpinning this 10 basis points downward revision was a combination of factors including subdued global trade and investment in advanced and emerging market economies, weaker than expected outturns in the second half of 2019 in key emerging market economies coupled with social unrest and the impact of weather-related disasters in several countries. Against this backdrop, many countries continued to adopt monetary policy easing in the second half of the year to support their economies in light of these weaker economic activities.

IMF's January 2020 global growth forecast for 2020 remains sluggish and is projected to recover slightly to 3.3%, a 0.1 percentage points lower than was projected in the October WEO. The downward revision primarily reflects negative surprises to economic activity in a few emerging market economies, notably India, which led to a reassessment of growth prospects over the next two years. To a lesser extent, it also reflects the impact of increased social unrest. However, the coronavirus (Covid-19) pandemic poses threats to this global outlook and is expected to weigh heavily on economic activity. While the IMF has not released an updated forecast, there are clear indications Covid-19 that the global economy will enter into a recession in 2020.

On the positive side, the uptick in growth is supported by the recent US-China partial trade agreement signed in January 2020 that is expected to de-escalate trade and technological tensions backed by gradual improvements in investment and trade in several emerging market economies in Latin America, the Middle East and emerging and developing Europe. However, an emerging downside risk expected to weigh down on near term growth is the recent Coronavirus outbreak which has created new uncertainty for the outlook with a greater likelihood that growth in China might slow to around 5%.

Growth in advanced economies is forecasted to ease to 1.6% in 2020, a 10 basis points downward revision from previous forecasts, reflecting downward growth revisions across several major advanced economies. In the United States (US), growth prospects are expected to moderate to 2.0% in 2020, a 10 basis points downward revision from 2.1% in the October WEO. This outcome reflects the economy's normalisation to a neutral fiscal stance and the anticipated waning support from the further loosening of financial conditions. Moreover, growth in the United Kingdom (UK) is expected to grow to 1.4% in 2020 consistent with earlier forecasts

following the materialisation of Brexit at the end of January leading to a transition into a new economic relationship.

Similarly, growth in the Euro area, a key export market for the country's fish, palm oil and coconut products, is projected to firm up from 1.2% in 2019 to 1.3% in 2020 reflecting improvements in external demand.

Turning to Asia, growth in Japan is expected to moderate from 1.0% in 2019 to 0.7% in 2020, a 0.1 percentage point higher than in the October WEO. The upward revision comes on the back of healthy private consumption supported by the government countermeasures to the 2019 October increase in the consumption tax rate as well as strong capital expenditure and historical revisions to growth.

Moreover, in emerging markets and developing economies, growth is projected to expand from 3.7% in 2019 to 4.4% in 2020. As for China, the main trading partner for the Solomon Islands, growth is projected to slow to 6.1% in 2019 and is expected to contract further to 6.0% in 2020 on the back of on-going structural slowdown following the protracted trade war with the US. Moreover, growth for 2021 is expected to decline further to 5.8%, its slowest increase since the 1990s. Furthermore, the Coronavirus outbreak in China in late December 2019 has lowered the near-term outlook for China as well as for some other Asian economies.

Similarly, economic activity in India for 2019 has slowed sharply to 4.8% from 6.1% in the October outlook reflecting continued weaknesses in domestic demand following tighter credit conditions in the non-banking sector. Meanwhile, growth prospects for India are expected to improve to 5.8% in 2020 and 6.5% in 2021 supported by monetary and fiscal stimulus and subdued oil prices.

Closer to the region, growth in Australia increased modestly by 0.4% to 2.0% in the December 2019 quarter compared to the 0.6% increase in the June 2019 quarter². The slower growth momentum reflected low-income growth of households, weak consumption growth and subdued business confidence on account of recent drought and bushfire related effects during the year. Meanwhile, early growth forecasts for 2020 are expected to strengthen from 2.0% in December 2019 to 2.75% in December 2020. This is driven by the expected increase in growth in consumption backed by ongoing improvement in housing market activity and moderate growth in household income. The advent of Covid-19 however, might see a turnaround in the projections for a modest outlook with the job losses and business closures likely to trigger a recession during the year.

¹All statistics in this section were obtained from the International Monetary Fund (IMF) World Economic Outlook, January 2020 Update, unless otherwise stated.

²Reserve Bank of Australia, Monetary Policy Statement February 2020.

In New Zealand, growth slowed over 2019 to 1.6% at the end of 2019 from 2.3% in September 2019. This moderation was driven mainly by low business confidence and headwinds from global economic conditions.³ However, in 2020, growth for New Zealand is expected to recover and accelerate to 3.1% at the end of 2020 in line with monetary and fiscal stimulus and high export prices, although this projection is weighed heavily downward with the impact of Covid-19 on the economy from March 2020.

Global inflation

Amid subdued economic activity and weak global demand conditions, both global and core inflation remained muted across 2019 for advanced and emerging market economies. In advanced economies, inflation is forecasted to rise from 1.4% in 2019 to 1.7% in 2020. On the other hand, inflation in emerging markets and developing economies eased from an estimated 5.1% in 2019 to a projected 4.6% in 2020.

On the regional front, inflation outcomes in Australia and New Zealand remained low and stable in 2019. Australia's headline inflation (seasonally adjusted) increased by 30 basis points to 0.6% in the December quarter from buoyed by price increases in automotive fuel prices and fruits and vegetables.⁴ It is expected to increase slightly to around 2.0% over the next couple of years as spare capacity in the economy declined. Meanwhile, core inflation eased to 0.4% in December

compared to 0.5% in September. Likewise, New Zealand's headline inflation rose 40 basis points to 1.9% in the December 2019 quarter from 1.5% in the September quarter reflecting the uptick in domestic capacity pressure and stronger wage growth. Headline inflation is projected to temporarily increase to 2.2% in the March 2020 quarter on the back of higher petrol and food prices as well with the previous one-off price increases for non-tradable components. Consequently, core inflation remained well within target at 2% in December 2019.

Global commodity prices

Based on the latest available data, the IMF's commodity price index rebounded by 5% in the December quarter after three consecutive quarters of subdued performance. This outcome reflected positive increases across major commodities during the quarter. Petroleum, food and energy index grew by 5%, 8%, and 7% respectively over the quarter. Tapis fuel price⁵ rebounded by 10% to an average of US \$74 per barrel at the end of December from the US \$67 per barrel in the previous quarter.⁶ This rebound in oil prices mainly reflected geopolitical tensions related effects following the September attacks on key oil refining facilities in Saudi Arabia. The non-fuel index also increased during the quarter by 3.0% against the previous quarter. Likewise, the food price index also rallied by 8% against the previous quarter.

³ Reserve Bank of New Zealand, Monetary Policy Statement February 2020.

⁴ Reserve Bank of Australia Monetary Policy Statement February 2020.

⁵ The main imported fuel for the Solomon Islands

⁶ Bloomberg

Chapter III. DOMESTIC ECONOMY

Overview

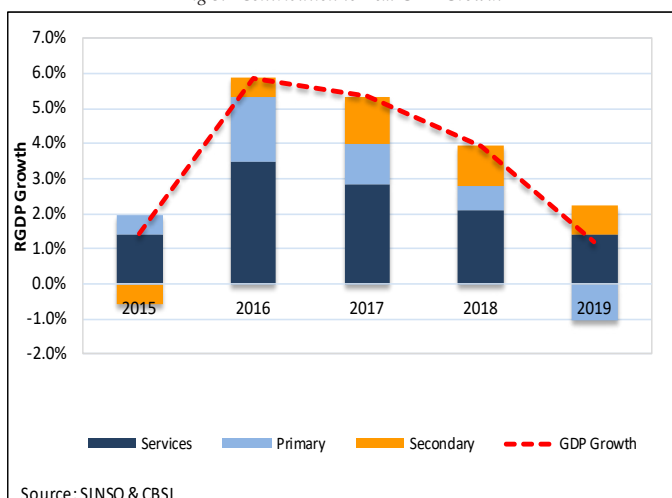
Domestic economic activities weakened considerably in 2019 due to external and domestic factors. On the external front, plummeting commodity prices and the US-China tariff trade war affected China’s demand for round logs – the country’s largest export. On the domestic side, there was a slower pace of activities following the lower income in round logs and agricultural cash crops, one-off disruptions of productivity to some sectors during the national general election period, and uncertainties during and after the diplomatic switch from Republic of China (Taiwan) to the People’s Republic of China. Also, lower government revenue constrained the capacity for a fiscal stimulus during the year.

Preliminary growth estimates by the CBSI showed that the economy slowed to 1.2% in 2019, a significant 2.7 percentage points lower than the estimated growth of 3.9% in 2018. With an estimated annual population growth of 2.3%, nominal income per capita in US dollar terms contracted by minus 1.9% to US\$2,089 per person. Employment as proxy indicated by SINPF’s contribution also slowed to 3.2% in 2019 from 5.3% in 2018. Given the softer demand in the domestic economy and favourable import consumer prices, particularly for food and fuel, inflation dropped to an average of 1.8% in 2019 compared to an average of 3.3% in 2018.

Gross Domestic Product (GDP)

The real GDP slowed considerably in 2019 to a growth of 1.2%, falling from a growth of 3.9% in 2018. The economic slowdown was estimated for a majority of the industries and a negative output in the agriculture and forestry – the two largest industries in the economy that have a direct impact on rural income earnings and government revenue.

Fig 3.1 Contribution to Real GDP Growth



Disaggregating the economy by sector, the primary sector dropped to a minus 3.3% growth in 2019

compared to a solid growth of 2.1% recorded in 2018 due to a significant decline in output for the agriculture and forestry sectors. The secondary sector went down to 5.9% in 2019 from 8.6% in 2018 attributable mainly to sluggish production in manufacturing. Similarly, the services sector weakened to 2.7% in 2019 from 4.0% in 2018 portraying slower demand in the economy during the year.

CBSI forecasted a recession in 2020 between minus 3.0% and minus 5.0% on the back of a negative impact associated with the Covid-19 preventive measures and very weak global economic conditions. Industries that are likely to have a larger negative impact include transportation and storage, hotel and restaurants, forestry, and manufacturing activities. This forecast considered the IMF anticipated negative global growth for 2020.

In the medium-term outlook, economic growth is forecasted at a range of 0.8% to 5.0%. This considers recovery economic support after the Covid-19 crisis, the construction of sports stadiums for the 2023 Pacific Games, donor-funded national infrastructure projects such as the JICA-funded Kukum-Highway Phase II road improvement, and resumptions of the Gold Ridge Mining. Meanwhile, the scale of the logging activity in the future is unknown, and a faster pace of descending output may deter the positive outlook.

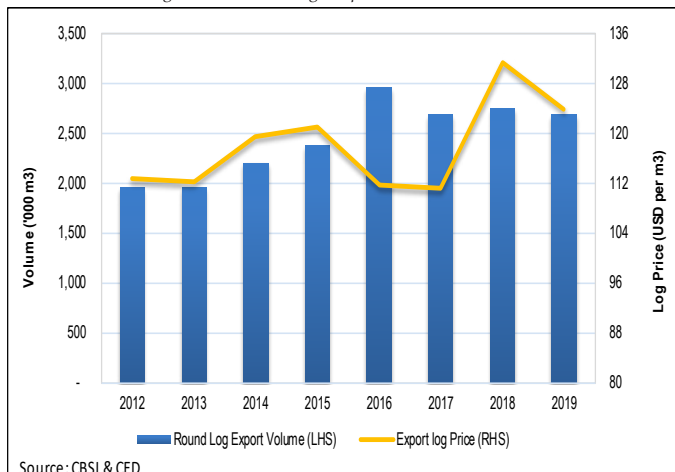
Production Index

The CBSI annual production index for major export commodities contracted by 2% to 99 points in 2019 from 101 points in 2018. This outcome was attributed to the declines in round logs, palm oil, copra, and coconut oil associated with weak commodity prices in the international market during the year. On a quarterly basis, the production index ending the fourth quarter dropped to 92 points compared to 93 points in the third quarter. This was driven by the weaker performances in round logs, cocoa, palm oil products, and copra.

Forestry

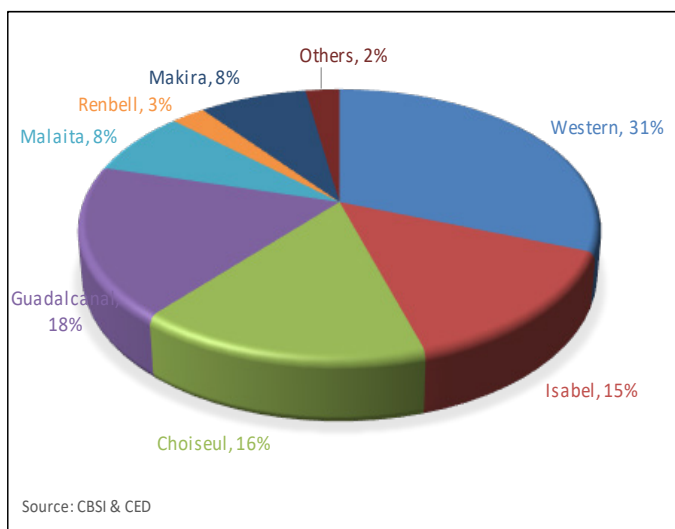
Annual round log production dropped by 2% to 2,678 thousand cubic meters. Natural logs fell by 4% to 2,455 thousand cubic meters in 2019 from 2,567 thousand cubic meters in 2018. The negative impact was due to a combined effect of lower log export prices and weaker demand from the Chinese economy, the main buyer of the country’s round logs. On the other hand, plantation logs jumped by 26% to 223 thousand cubic meters due to higher shipments in the second quarter of 2019.

Figure 3.2: Round Logs Export Volumes and Prices



In terms of composition, natural forest logs accounted for a sizable 91% share and plantation logs with 9%. Production by provinces showed that Western province accounted for a larger share of 31%, followed by Guadalcanal province by 18%, Choiseul province by 16% and Isabel province by 15%. The other provinces comprised less than 10% each.

Figure 3.3: Round Log Production Share by Provinces in 2019



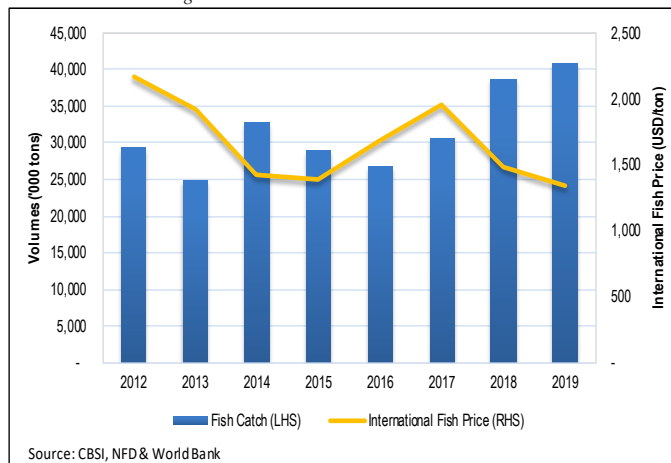
Log export prices received by log exporters dropped during the year by 8% to US\$121 per cubic meters from US\$131 per cubic meters in 2018 (see Fig 3.2). On the contrary, according to the World Bank data, log prices picked up slightly by 1% to an annual average of US\$273 per cubic meters at the end of 2019.

Fishing

The fishing sector performed positively during the year, although export values were negatively impacted by the fall in fish prices. Annual fish catch increased by 6% to 40,859 tons in 2019 due to an increase in longline boat capacity and favourable weather conditions during the year. Meanwhile, international fish prices continued to fall in 2019 by 10% to US\$1,343 per ton resulting from an excess supply of tuna from the central

pacific. A significant fall was witnessed in the third quarter and after that remained stagnant throughout the first half of the year. In the fourth quarter, fish price improved, although not sufficient to compensate for the lower price through the first three quarters.

Figure 3.4 Fish Catch and International Prices

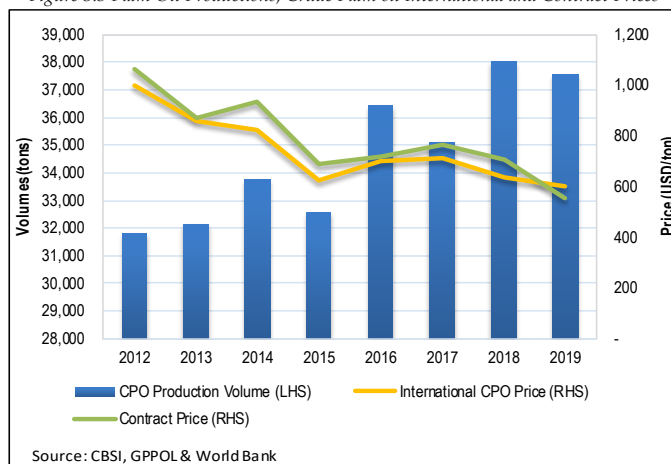


In line with high fish catch during the year, canned tuna production and processing also improved with canned tuna output increasing by 10% to 7,124 tons from 6,506 tons recorded in 2018. Of the 7,124 tons produced in 2019, 80% was for domestic consumption and 20% got exported. Similarly, loins and fishmeal production went up 5% and 4% to 30,159 tons and 2,151 tons respectively.

Palm Oil

Palm oil activities showed weaker performance in 2019 compared to 2018. Harvested fresh fruit bunches dropped by 2% to 157,012 tons from 161,001 tons recorded in the previous year. As a result, the annual production for crude palm oil dropped slightly by 1% to 37,536 tons, and palm kernel oil fell by 4% to 3,743 tons. This outcome reflected the lower output in the second half of 2019.

Figure 3.5 Palm Oil Productions, Crude Palm oil International and Contract Prices



The average contract price for both palm kernel oil and crude palm oil deteriorated in 2019. Palm kernel oil declined by 17% to US\$1,169 per ton while crude palm oil

fell by 21% to US\$556 per ton. Similarly, the International price for crude palm oil fell 6% to US\$601 per ton.

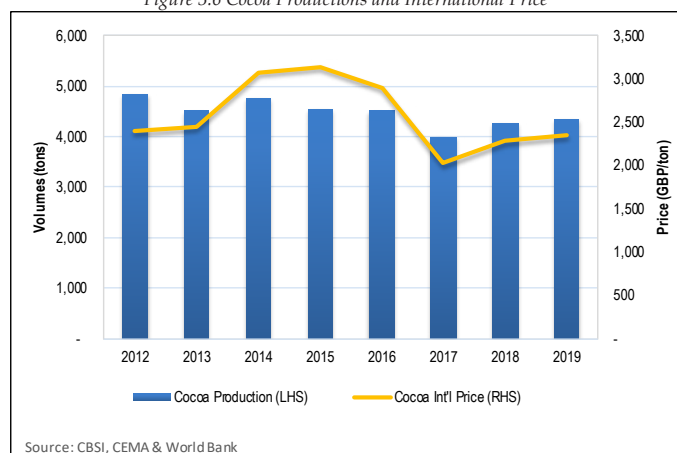
Cocoa

Annual cocoa production grew further by 2% to 4,335 tons in 2019. This outcome reflected the higher yields during the second and third quarters, coupled with the increased cocoa price in the global market.

Disaggregating cocoa production by provinces; Guadalcanal province, remained the top cocoa producer with 2,465 tons (57%) followed by Makira province with 982 tons (23%), Malaita province contributed 815 tons (19%). Other provinces accounted for the remaining 72 tons (2%).

In terms of prices, the average contracted price received by cocoa exporters increased by 11% to GBP 1,506 per ton, compared to GBP 1,362 per ton a year ago. Similarly, cocoa international price rose steadily by 2% to US\$2,342 during the year. This outcome reflected a rising demand for cocoa products combined with buyers from Europe raising the minimum export price for Ivory Coast and Ghana – the two leading cocoa producers in the world. With the favourable world cocoa prices, the domestic cocoa price rebounded by 5% to \$11.07 per kilogram from \$10.58 per kilogram during the period.

Figure 3.6 Cocoa Productions and International Price



Copra and Coconut Oil

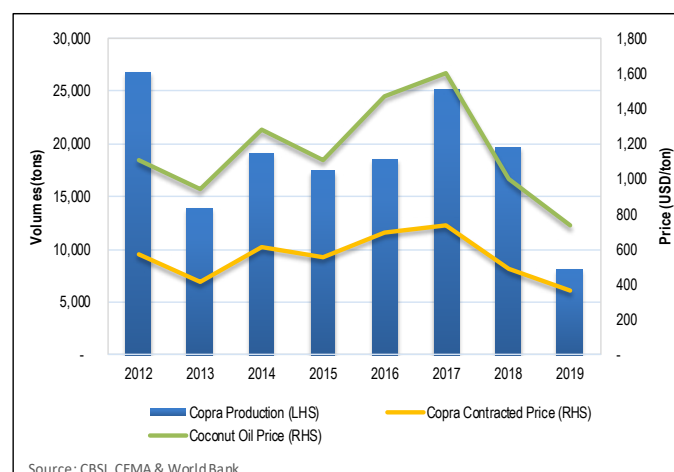
Copra and coconut oil production weakened significantly in 2019. Copra output plunged more than two-fold from 19,660 tons in 2018 to only 8,055 tons in 2019. This was the lowest record for the past ten years as production in all the provinces dropped. Moreover, coconut oil production also dropped from 5,300 tons in 2018 to 4,500 tons in 2019. The underperformance in the copra and coconut oil industries stemmed from low export prices during the year which discouraging farmers from producing copra and coconut oil.

Disaggregating copra production by provinces, Central province remained the most significant

contributor with a share of 36% (2,860 tons), followed by Guadalcanal province with 21% (1,720 tons), Choiseul province with 17% (1,341 tons), and Western province with 14% (1,130 tons). These four provinces comprised a total share of 88%. Makira with a share of 5%, Malaita with 4%, Isabel with 2% and Temotu with 1% make up the remaining 12%.

The average contract price for copra dropped markedly by 24% US\$370 per ton in 2019 from US\$490 per ton in 2018, resulting in domestic dried copra price received by local farmers to drop from \$2.83 per kilogram to \$2.49 per kilogram. Likewise, the international price for coconut oil dropped significantly by 27% to US\$733 per ton in 2019 against the previous year. This was attributed to soft demand in the global market.

Figure 3.7: Copra Productions, Copra Contract Prices, and International Coconut Oil Prices



Other agricultural products

Kava¹ production dropped in 2019 to 9 tons from 13 tons in 2018. On the other hand, coffee increased from 0.8 tons to 1.7 tons. These two niche products, although relatively low volumes compared to traditional agricultural cash crops have the potential of providing an alternative source of income for rural farmers that have suitable soil and climate conditions.

Mining

In 2019 bauxite mining continued in Rennell and Bellona province. Mining extraction improved in 2019 reflecting higher mineral exports during the year (see Chapter IV. Balance of Payments section). Bauxite mining in the first half of 2019 slowed partly contributed by a bauxite bulk carrier grounded off the reef at Rennell Island due to severe adverse weather disrupting bauxite activities. However, in the second half of 2019, Bauxite exports jumped up due to higher shipments. On gold mining projects, the Gold Ridge Mine was relaunched in October 2019 after its closure in 2015. Gold Ridge landowners have made a joint venture with overseas investors to reopen and

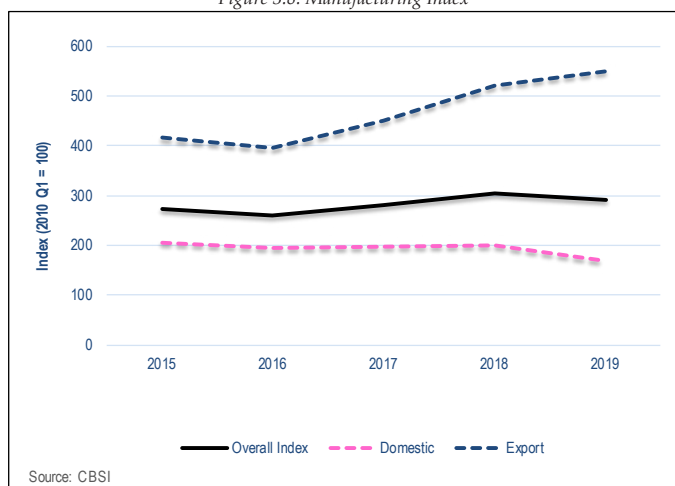
¹ Kava is exported to the US and other Pacific Island Countries.

complete reconstruction of the mine site. It is envisaged full operations should commence when normalcy resumes after the covid-19 crisis.

Manufacturing

The manufacturing activity weakened in 2019 as the manufacturing index dropped 4% to 291 points compared to 2018. This was mainly driven by manufactured goods for domestic consumptions such as biscuits, alcohol, soft drinks, and tobacco which fell significantly by 16% to 169 points. On the contrary, manufactured goods for exports which are primarily tuna products increased by 6% to 549 points.

Figure 3.8: Manufacturing Index



On the quarterly movements during the year, the manufacturing activity slowed in the first quarter and then fell in the second quarter to a greater extent affecting alcohol production due to the liquor ban in Honiara and Guadalcanal in the week for the Prime Minister's election. In the third quarter, the manufacturing activity picked up but then dropped again in the fourth quarter as many workers went for the festive holidays in December.

Electricity

Total electricity generated by Solomon Power grew by 2% to 99,080 megawatts hour (MWh) from 96,952 MWh in 2018. Of the 99,080 MWh generated in 2019, the total units sold expanded by 2% to 78,295 MWh compared to 76,884 MWh sold in 2018. The increase in sales to domestic, commercial and industrial users contributed to this outcome. Units sold to domestic users rose by 4% to 17,369 MWh, and units sold to commercial and industrial users grew by 3% to 50,931 MWh. On the other hand, units sold to government users contracted by 6% to 9,996 MWh during the year.

In terms of electricity prices in 2019, the tariff rate increased across all three categories of users against the previous year. However, the magnitude of increase was relatively lower than the rise in 2018. Tariff for domestic users increased 13 cents to \$6.40 per KWh, commercial users by 26 cents to \$6.32 per KWh, and

industrial users by 32 cents to \$6.37 per KWh.

Foreign Direct Investments (FDI) Applications

The total number of FDI applications approved by the Foreign Investment Division of the Ministry of Commerce fell by 42% to 118 applications in 2019. Despite this fall, the estimated total value indicated by the foreign investors rose 20% to an estimate of \$526 million. The fourth quarter of 2019 saw an upsurge of the investment values of a few investors from Singapore who were optimistic in investing in the tourism and fisheries sectors.

Of the total FDI applications, the service sector accounted for the largest share with 88 applications (75%) which is dominated by wholesale and retail trade with 51 applications. The secondary sector accounted for the second largest share with 19 applications (16%) representing construction, mining, and manufacturing. The primary sector accounted for the least share with 11 applications (9%) and comprised of agriculture, fisheries, and forestry sectors.

Distribution by provinces showed Honiara continued to be the main target business destination with 98 applications (83%) followed by Guadalcanal with 12 applications (10%), Western with 5 applications (4%), Isabel with 2 applications (2%), and Malaita with 1 application (1%).

Composition of FDI applications by country of origin reported mostly China and Australia with 46 applications (39%) and 23 applications (19%) respectively. Other Asian countries excluding China accounted for 29 applications (25%) while other Pacific Island Countries (PICs) recorded 9 applications (8%). The remaining 11 applications (9%) were from other regions excluding PICs and Asia.

Tourism

Total visitor arrivals in 2019 dropped by 5% to 30,821 visitors from 32,434 visitors in 2018. This outcome was driven mainly by a significant fall in sea arrivals despite the slight increase in air arrivals. Sea arrivals declined further by two-fold from 4,568 visitors to 1,888 visitors in 2019 as there were no cruise ships to the country in the fourth quarter of 2019 on the back of the measles outbreak in the Pacific. Meanwhile, air arrivals grew by 4% to 28,933 visitors in 2019, resulting from a higher number of arrivals in the fourth quarter and also surge in visitors transiting. The high number of arrivals in the fourth quarter was due to a significant number of visitors for holidays in December including the Seventh Day Adventist Church Pathfinders participants from other Pacific island countries travelling to Honiara for their camporee.

In March 2019 the new Solomon Airlines route for Brisbane-Munda commenced and recorded a total

of 1,183 visitors arriving at Munda International Airport during the year. Meanwhile, visitors arriving at Honiara International Airport recorded a total of 27,750 visitors in 2019, which is lower by 116 visitors against the previous year. This suggested that visitors travelling via Brisbane for Honiara utilized the new Brisbane-Munda route more during the year. The average length of stay for visitors dropped to 13 days in 2019 compared to 15 days in 2018.

Disaggregating air arrivals by regions, Oceania region represented 67% of total arrivals and Australia remained the largest source of visitors with 38% of the total arrivals. Asia accounted for 17%, Europe with 8%, and America representing 7%. In terms of air travel by purpose, holiday and vacation accounted for the majority of visitors with 31%, followed by others category not stating their purpose of visit representing 26%, business, and conference visitors accounted for 25%, visitors for visiting friends and relatives with 14%, and those visitors transiting and stopover representing 4%.

Transport

Activities in the Transport sector slowed down during the year as a result of weakened sea and land transport indicators. Proxy indicator for sea transport based on the index of cargo volume handled by Solomon Islands Ports Authority both at Honiara and Noro international seaports declined by 12% to 105 points compared to 119 points in 2018. Moreover, the Index for cost, insurance, and freight (CIF) imports of vehicles as a proxy indicator for land transport dropped considerably by two-fold to 55 points. On the contrary, the passenger numbers from Solomon Airlines as a proxy indicator for air transport increased by 5% to 114 points in 2019 due to higher domestic and international passengers. The newly introduced Brisbane-Munda route also contributed to the higher number of passengers.

Construction

Construction activity indicators showed a mixed result in 2019. The total approved building permits issued by the Honiara City Council contracted by 18% to 278 permits from 340 permits registered in 2018. Of the total permits, residential comprised 122 permits, commercial and industrial accounted for 69 permits, and 87 permits for 'others' category. In terms of value, the total value for the approved building permits was recorded at \$208 million from \$471 million in 2018. Moreover, cement imports (CIF) dropped by 5% to \$36 million, implying slower demand for construction activity that requires higher cement components.

Other partial indicators for the construction activities showed positive outcomes during the year. Commercial bank loans to the construction sector increased by 11% to \$494 million compared to \$444 million in 2018. Out of the \$494 million, loans for private residential properties surged by 16% to \$233 million, loans for commercial and industrial properties increased by 10% to \$238

million. On the other hand, loans for land developments dropped by 9% to \$24 million during the year.

On major national construction projects, the one-off laying of the undersea cable from Sydney to Honiara was completed in 2019 including the domestic component connecting Honiara to Noro, Auki and Taro townships. This is a major milestone achieved in lifting communication to a new height in the country. Australian Government-funded two-thirds of the cost of more than AUD136 million.

Communication

The communication services remained buoyant during the year. The communication index surged by 44% to 247 points in 2019 from 172 points in 2018. Mobile calls almost doubled to 269 points from 143 points, and internet usage also improved further by 28% to 260 points. This reflected the expansionary and coverage services by the communication industry and increasing demand for communication from businesses and the general public.

With the commissioning of the Undersea Submarine Cable in 2020, communication services are anticipated to remain buoyant benefiting customers with greater internet connectivity and contributing to the efficiency of business operations in general.

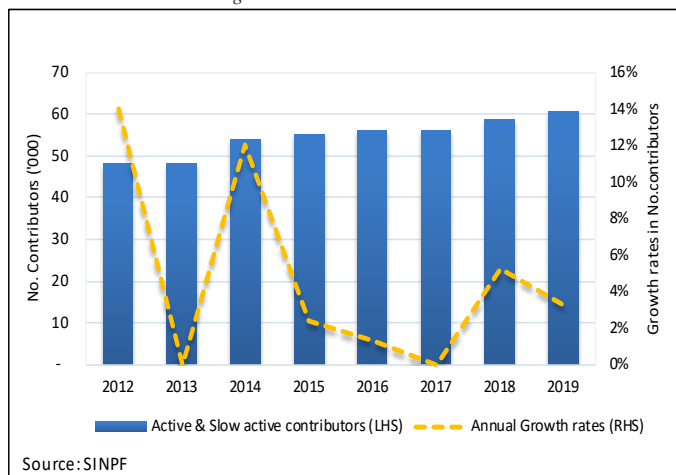
Wholesale and Retail Trade

The wholesale and retail trade service slowed in 2019, as shown by four indicators for the sector. The index for total imports (CIF) for food, alcohol, and tobacco remained flat at 123 points same as in 2018, reflecting overall stagnant demand. Furthermore, FDI applications for wholesale and retail dropped significantly by 47% to 51 applicants. Meanwhile, lending to wholesale and retail increased 13% to a total stock of \$558 million at the end of 2019, an additional \$62 million in 2019. Moreover, SINPF contributors in the wholesale and retail sector increased 18% to a total of 11,169 (active and slow active) contributors, an additional 1,729 contributors in 2019.

Labour Market and Employment

The labour market conditions based on employment indicators showed improvements in 2019, although at a slower pace. Proxy employment conditions based on the number of SINPF's 'active and slow active' contribution category, grew by 3%, an additional 1,907 contributors during the year to a total of 60,643 contributors at the end of 2019. Despite the contributor's positive growth, it reduced from a 5% growth in 2018 impacted by slower growth in the economy. An additional indicator reflecting slowing labour market conditions is the CBSI tally on the vacancies advertised in the newspapers which dropped to 544 vacancies in 2019 from 953 vacancies in 2018.

Figure 3.9: SINPF Contributions



Growth in the Public Service Employment (PSE) by the Solomon Islands Government, the largest employer in the country, remained stable in 2019. At the end of 2019, PSE grew by 2%, the same growth in 2018. At the end of 2019, there were 18,190 filled positions, an increase of 291 positions from 17,899 positions at the end of 2018. Employment towards education, health, and policing services comprised 84% of the jobs in 2019. The education sector composed 60%, and the health and policing services, each comprised 12%.

Apart from permanent employment, two significant national commitments provided one-off short-term or contract jobs in the market in 2019. These included the engagement of polling officers for the national elections in April and field enumerators for the 2019 National Census in November. Also, the World Bank’s Community Access and Urban Services Enhancement (CAUSE) project provided 2,528 jobs during the year, of which 352 were youths.

Considering unemployment absorption in the economy from abroad, short term workers to Australia and New Zealand under the Recognised Seasonal Employer (RSE), Seasonal Worker Program (SWP), and Pacific Labour Scheme (LPS) increased significantly by 31.4% to 1,130 Solomon Island workers to Australia and New Zealand. These schemes benefited Solomon Islanders not only on providing jobs to local Solomon Islanders who would have been unemployed but also on a range of other benefits such as remittances.

Moreover, in terms of employment abroad, the demand for local registered nurses by the Republic of Vanuatu, resulted in more than 70 local nurses contracted to work in the neighbouring country in 2019. Such initiatives eased the window of securing jobs for newly graduated nurses, although this may have compromised the quality of health service particularly with more experienced nurses leaving the country.

Inflation

The national headline inflation (3 months moving average) was relatively at low levels in 2019. Inflation was recorded at 2.8% in December 2019 compared to 4.2% in December 2018. Similarly, on an annual average, the headline inflation was 1.8% in 2019, a significant drop from 3.3% in 2018. This was driven by deflation (inflation below zero or negative) for imported items beginning February 2019 and falling domestic inflation in the first half of 2019.

Info Box 1. Introduction of the National Consumer Price Index (NCPI) as the basis for measuring inflation in the Solomon Islands.

The Solomon Islands National Statistics Office (SINSO) began publishing a new statistical series, the National Consumer Price Index (NCPI) starting in August 2019. The series represents a break from the previous Honiara Consumer Price Index (HCPI) to a more national measure of consumer prices.

The NCPI covers consumer prices in four main townships in the country, namely Honiara, Auki, Noro, and Gizo. Previously, the Consumer Price Index (CPI) for the country only covered Honiara, which is the HCPI. Earlier annual reports on inflation published by the Central Bank of Solomon Islands (CBSI) were based on HCPI.

In terms of weights for the four townships, Honiara as a centralized capital city has a larger weight of 88% and therefore heavily drives the outcome of the NCPI. As such, fluctuations (or movements) of the overall headline inflation under the NCPI remained broadly the same as that of HCPI.

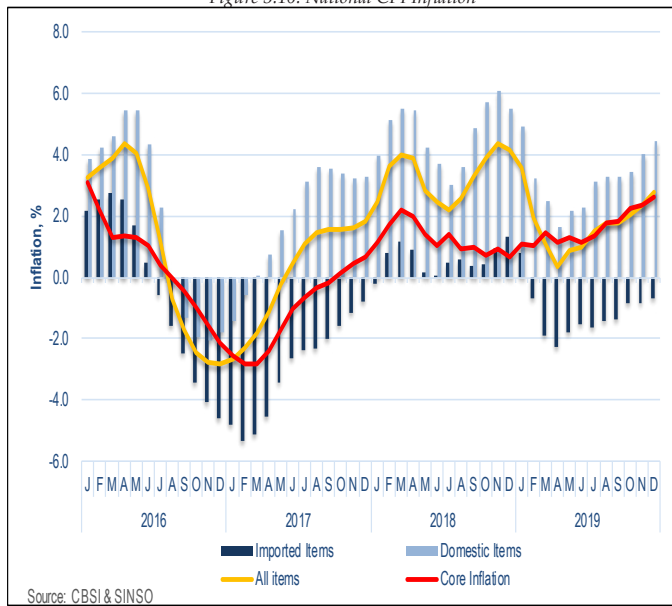
For economic reporting, CBSI has been reported headline inflation based on the NCPI commencing from the September 2019 Quarterly Economic Review to ensure consistency with the SINSO inflation publications. Meanwhile, CBSI will continue to monitor the movements of the NCPI and HCPI for policy purposes.

Annual average imported inflation dropped to minus 1.2% (a deflation) from 0.6% in 2018. The fall to minus territory was attributed to the declining imported food and fuel prices following the plunge in world commodity prices and global growth in 2019. Moreover, domestic inflation on average went down from 4.7% to 3.2% owed to a decline in the price for domestically produced goods and services from four key basket categories; ‘Food & Non-Alcohol Beverages’, ‘Clothing and Footwear’, ‘Furnishing, Household Equipment, and Routine Maintenance’ and ‘Hotel and Restaurants. That offset the rising prices for ‘Alcohol Beverages, and Tobacco Nicotine’ and ‘Housing, Water, Electricity and Other Fuels’ categories.

In terms of the monthly movements in 2019, headline inflation started with a peak of 3.6% in January and dropped to a trough of 0.4% in April driven mainly by declining prices of imported items in particular food and fuel. Meanwhile, as from May inflation picked up each month and stood at 2.8% at the end of 2019 primarily driven by a general increase in prices for

domestic items and higher added government tax rates on rice, alcohol, and tobacco in September 2019.

Figure 3.10: National CPI Inflation



Core (or Underlying) inflation² in 2019 although at moderate levels, rose over the second half of the year. Core inflation was 2.6% in December 2019, higher than

0.7% in December 2018. On an annual average, core inflation in 2018 remained at the same rate of 1.6% as in 2018 indicating pressure on inflation from demand-side factors is minimal. During the first seven months of 2019, core inflation fluctuated between 1% and 1.5% but picked up from August reaching 2.6% at the end of the year. This reflected a steady rise in non-food and non-fuel consumer items.

Considering the average inflation split for the four townships in 2019, Gizo has the lowest inflation rate at an average of 0.8%, followed by Honiara with an average of 2.3%, Auki with an average of 3.2%, and finally Noro with the highest rate of 3.9% in average.

²Measures of underlying inflation excludes items with volatility, price control, & excises.

Chapter IV. BALANCE OF PAYMENTS

The Solomon Islands' overall balance of payments position slumped to a deficit of \$292 million in 2019, a reversal from the \$527 million surplus in 2018. Driving this outcome was the deterioration in the current account balance to a deficit of \$1,167 million from a revised \$389 million deficit a year ago, despite an increase in the capital and financial account surplus to \$737 million. As a result, the gross foreign reserves fell by 6% to \$4,706 million by the end of the period, and was equivalent to 11.9 months of imports.

	2017	2018	2019 ^P
A. Current Account	-495	-389	-1,167
Goods	45	45	-323
Services	-718	-590	-988
Primary Income	-234	-164	-104
Secondary Income	412	320	248
B. Capital & Financial Account	790	614	737
Capital	477	478	598
Financial Account (excl. reserve asset) 1/	312	136	139
C. Net Errors and Omissions	-76	302	138
D. Overall BOP Position (+ve=surplus)	218	527	-292
F. Financing	-218	-527	292
Official Reserves (-ve=increase)	-217	-527	290
IMF Program (-ve=decrease)	-1	1	1
Position of Gross Foreign Reserves at end	4,535	4,984	4,706
Months of import cover of goods and services	11.3	12.4	11.9

1/ BOP analytical presentation shows reserve asset and IMF loans as financing in Item E. In BPM6 statistical presentation the financing items are part of account.

p- Provisional
Source: CBSI

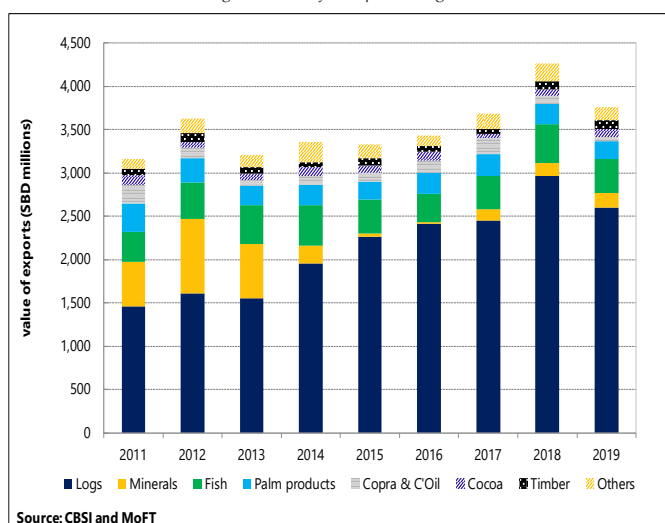
The widened current account deficit reflects the higher deficit balance in both the trade in goods and services and in primary income, along with the lower surplus in the secondary income. Meanwhile, the capital and financial account surplus rose to 7% of GDP in 2019 from 6% recorded a year ago attributable mainly to the increase in capital grants in 2019.

Trade in goods

The balance of trade in goods turned to a deficit of \$323 million in 2019 from a revised \$45 million surplus witnessed in the previous year. This outcome resulted from a fall in exports by 12% to \$3,758 million, amidst a 3% decrease in imports to \$4,081 million.

The fall in export receipts over the period stemmed from a decrease in major export commodities mainly agriculture, forestry, and fisheries. The negative outcome reflected unfavourable market conditions coupled with slow production performances by the forestry and fisheries sectors over the year.

Figure 4.1: Major Export Categories



Round log export receipts, which accounted for 69% of total exports for the year, declined by 12% to \$2,601 million following a 21% growth in 2018. This decrease was driven by lower export volumes, particularly in the second half of the year and a decrease in market demand, especially from China. Sawm timber exports meanwhile jumped by 17% to \$105 million, reflecting higher export volumes and relatively favourable market prices during the year.

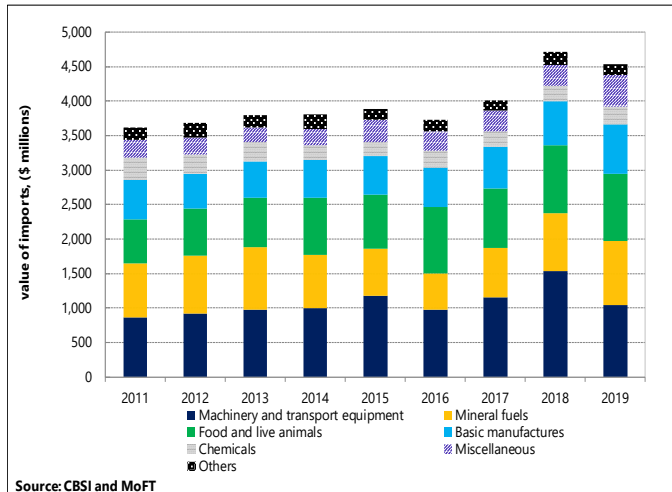
Fish exports also went down during the year by 11% to \$398 million, driven by a drop-in fish prices over 2019. This is despite recording higher domestic fish catch, loins, and fishmeal production volumes during the year compared to 2018.

Palm oil exports which dominated the agriculture sector tumbled further in 2019 by 14% to \$201 million compared to a 6% fall in 2018. This emanated from a decrease in contracted and international market prices and lower production during the year. The European Union remained the main export destination of palm oil exports. Meanwhile, Cocoa exports rebounded strongly by 30% to \$95 million, buoyed by favourable international prices and sustained production volumes. In contrast, the exports of copra and coconut oil dropped sharply for the second consecutive year by 50% to \$48 million, due in part to subdued international prices for both copra and coconut oil capped with lower production during the year. On the upside, mineral exports went up by 8% to \$162 million in the year and are represented by an increased number of bauxite shipments and alluvial gold exports during the year.

The fall in total imports in 2019 emanated from the downturns in machinery and transportation and marginal fall in food imports. Machinery and transport equipment dropped by 32% to \$1,042 million while food dropped marginally by 0.5% to \$979 million.

Meanwhile, other major import categories such as fuel, chemicals, basic manufactures, beverages, and tobacco, recorded an increase over the year. Mineral fuels went up by 10% to \$926 million from the previous year reflecting higher volume of imports in the second half of 2019 as global oil prices remained favourable. Basic manufacture rose by 13% to \$719 million and chemical imports grew by 11% to \$257 million. Furthermore, beverages and tobacco rebounded by 38% to \$92 million while crude material imports grew marginally by 1% to \$39 million.

Figure 4.2: Major Import Categories



Likewise, miscellaneous import items grew by more than half to \$451 million, while vegetable and animal, oil & fats rose by 14% to \$32 million during the year.

Trade in Services

The deficit in services widened to \$988 million from \$590 million in the previous year. This was mainly driven by a widening deficit in other services from \$621 million to \$876 million. This was supported by import of services done by a non-resident company in the third quarter for construction and telecommunication services associated with the roll-out of the submarine cable infrastructure in the period. On the other hand, the deficit on net transport services improved by 13% to \$167 million reflecting falls in payments for stevedoring services. Meanwhile the surplus in net travel services shrank from \$223 million to \$55 million and was explained by a drop-in travel inflow in particular, the decline of cruise ship visits in the year.

Primary Income

The primary income balance ended the year with a lower deficit of \$104 million compared to a revised deficit of \$164 million in 2018. This positive outcome was primarily driven by a reduced deficit in investment income during the year and improvement in other primary income surplus. The improvement in the investment income deficit to \$295 million from \$342 million deficit a year ago, can be explained from slow dividend payments by FDI enterprises and a surge

in interest income on the country's foreign reserves. Compensation of employees turned to a deficit of \$2 million reflecting higher repatriation of salary and wages during the year. Meanwhile, the increase in other primary income surpluses represented by fishing licenses rebounded by 19% to \$192 million.

Secondary Income

The secondary income surplus continued to decline during the year by 23% to \$248 million from \$320 million in the previous year. This was mainly due to private sector net transfers which widen by almost three-fold to a deficit of \$245 million. This was driven by a spike in workers' outward remittance during the year while other net transfers surplus tumbled by 18% to \$225 million surplus.

On the other hand, the general government transfers recorded net transfer receipts of \$493 million, a 23% increase over 2018. This reflected more aid receipts on cash, technical assistance, and aid-in-kind during the period. Donor partners have continued to fund a wide range of programs throughout the year covering economic growth, public governance and essential services including health and education.

Capital

Capital account surplus recorded a 25% jump to \$598 million in 2019 from \$478 million in the previous year. This reflected an increase in official aid assistance to the general government from its development partners both on new and on-going capital projects during the year. The construction of the undersea cable combined with the upgrade of bridges and wharves and other smaller infrastructure projects contributed to the rise.

Financial

The financial account in 2019 improved by 2% to a surplus of \$139 million from a revised \$136 million surplus a year ago. This outcome stemmed from direct investments net inflows which posted a surge by more than half to \$207 million from a revised \$126 million surplus.

This was driven by an increase in reinvested earnings from foreign direct investments (FDI) firms by 20% to \$176 million and a marginal growth of 1% in equity and investment funds to \$110 million. Debt instruments, however, recorded a fall reflecting offset of intercompany lending.

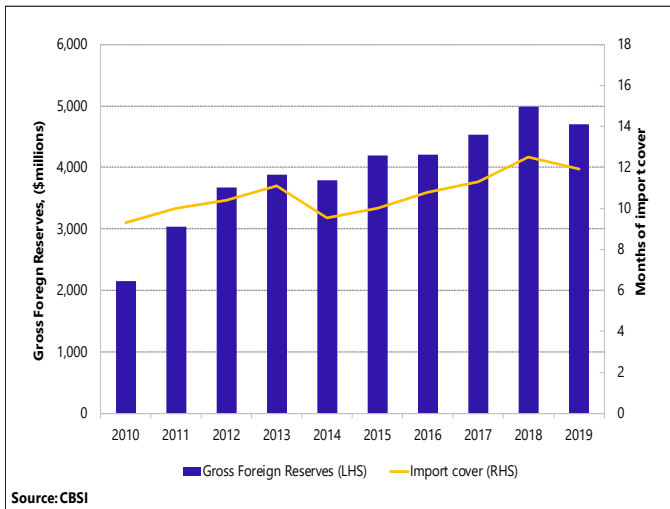
In contrast, other investments posted a \$38 million deficit from a \$9 million surpluses in 2018. Additionally, the portfolio investments recorded a deficit of \$31 million from the \$1 million surplus in the previous year.

Reserves

The country's gross foreign reserves position fell by 6% to \$4,706 million (US\$577 million) at the end of 2019

from \$4,984 million in 2018. This was driven mainly by a net outflow of \$290 million in transactions against revaluation gains in the December quarter. The deficits in the net transactions were attributed to the decline in foreign export earnings due to the slowdown of the Chinese economy coupled with demanding trade payments. On the other hand, the revaluation gains can be explained by the depreciation of SBD against the USD. Consequently, the current reserve position is adequate to cover 11.9 months of imports of goods and services.

Figure 4.3: Gross Foreign Reserve



International Investment Position

The international investment position (IIP) records the country’s stock of external assets and liabilities and reflects its balance sheet position with the rest of the world. During the review period, the net IIP registered a provisional deficit of \$336 million, a deterioration from the revised \$99 million surplus in 2018. This outcome came from the fall in the stock of financial assets, which decreased by 4% to \$6,033 million and the growth in the stock of liabilities by 3% to \$6,370 million. The downturn in assets was driven by a decline in other investment and reserve assets by 4% and 6% to \$601 million and \$4,706 million respectively. Meanwhile, direct investment assets rose by 3% to \$556 million coming from investment in firms abroad and portfolio assets that grew by 23% to \$169 million.

The growth in the stock of liabilities was mainly due to a 5% increase in direct investments into the country to a position of \$4,900 million by the end of 2019. In contrast, the stock of other investment liabilities dropped by 2% to \$1,470 million owing to the offset of trade credits during the year.

Gross External Debt

The provisional total external debt position for both the public and private sectors at the end of 2019 stood at \$2,496 million, a decline of 3% from a revised \$2,564

million in the previous period.

	2017	2018	2019 ^P
Gross External Debt Position	2,592	2,564	2,496
(i) Public Sector External Debt	986	934	935
General Government	812	770	802
Central Bank	175	164	133
(ii) Private External Debt	1,606	1,630	1,561
Deposit - Taking Corporations	106	220	225
Other Sectors	377	351	309
Direct Investment : intercompany Lending	1,123	1,059	1,027

p- Provisional
Source : CBSI

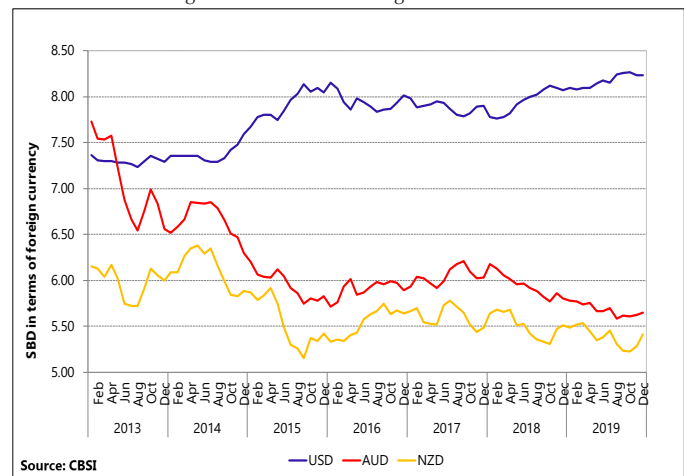
This was driven mainly by a 4% fall in external borrowings from the private sector to \$1,561 million. The decrease in private sector debt was attributed to a fall in other sectors’ debt by 12% to \$309 million and intercompany lending by 3% to \$1,027 million. Meanwhile, deposit taking corporations’ debt grew by 2% to \$225 million.

In contrast, the public external debt recorded a slight increase in stock by 0.1% to \$935 million owing to an increase of 4% to \$802 million in the general government’s external debt. In contrast, the Central Bank’s external debt fell by 18% and to \$133 million by end 2019.

Exchange Rate

In terms of the exchange rates measured on an annual average basis, the Solomon Islands Dollar (SBD) depreciated against the United States dollar (USD) by 2.7% to \$8.17 per USD. This reflected the strong performance of the US dollar in the global currency markets. Although the SBD strengthened against the USD by 0.1% to \$8.09 per USD in the first quarter, it weakened by 1.3% in the remaining three quarters.

Figure 4.4: Bilateral Exchange Rate Trends.

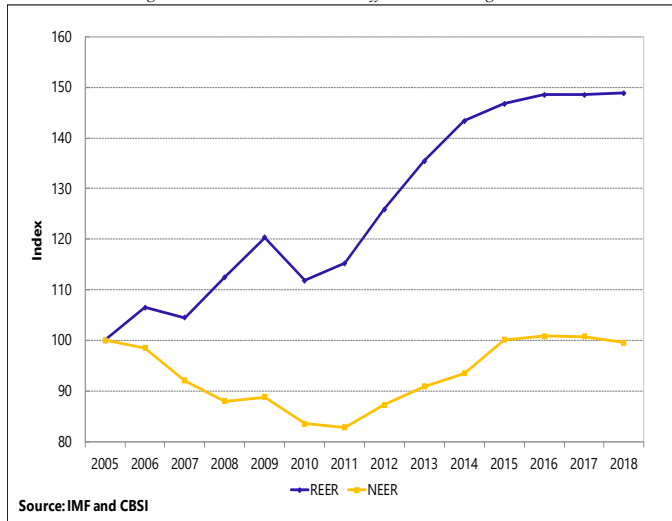


The SBD also depreciated against the Japanese yen by 4.0% to \$7.50 per 100JPY during the year. On the other

hand, the SBD strengthened against the Australian dollar by 4.7% to \$5.68 per AUD, 1.7% against the Great Britain pound to \$10.43 per GBP, 2.2% against the New Zealand dollar to \$5.39 per NZD, and 2.6% against the Euro at \$9.15 per EUR. In terms of the trade-weighted index (TWI), on an annual average basis, it depreciated by 3% to 111.1 from 107.8 in 2018. This reflected the changes in the nominal USD vis-à-vis the SBD as it has been the predominant bilateral currency in the TWI.

of the SBD against key currencies such as the AUD, NZD, and the GBP. Furthermore, the rise in the NEER ultimately led to an average 0.14% appreciation in the Real Effective Exchange Rate (REER) from an index of 126.5 to 126.6. The gap between the REER index of 126.7 and the NEER index of 116.0 in 2019 indicates the differences in consumer prices in the Solomon Islands and its trading partners. An appreciation in the REER tends to suggest a loss in trade competitiveness during the year.

Figure 4.5: Real and Nominal Effective Exchange Rates.



On the other hand, the average Nominal Effective Exchange Rate (NEER) in 2019 appreciated by 0.7% to an index of 116.0 from 115.3 in the previous year. This upward movement is associated with the appreciation

Chapter V. MONEY AND BANKING

Monetary Developments

In line with the subdued economic environment, monetary developments weakened in 2019 with falls in reserve money (M0), narrow money (M1), broad money supply (M3) and liquidity. Meanwhile, credit issued to the private sector in the banking system grew by 6% from the previous year, as the weighted interest rate margin further narrowed. In September, CBSI adopted an accommodative monetary stance in the course of gradual monetary easing to support the economy after the moderate tightening stance in the first half of 2019.

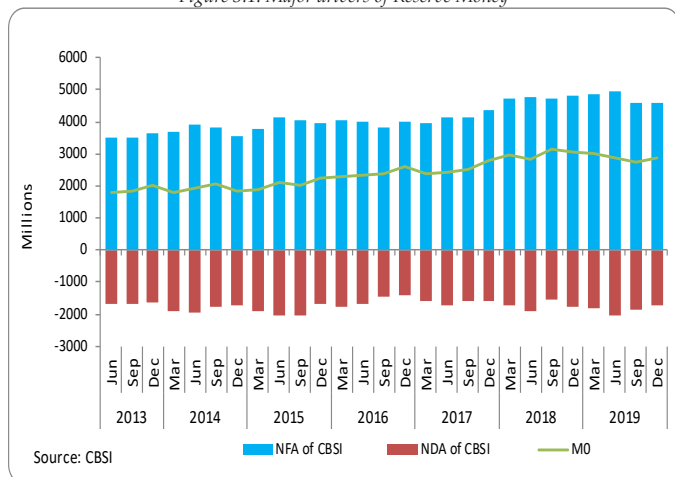
Reserve Money

Reserve money (M0) declined by 7% to \$2,852 million by the end of 2019, following the 11% year on year growth recorded in 2018. This result reflected the fall in other depository corporations' (ODCs) deposits by 10% to \$1,934 million that outweighed a 0.3% increase in currency in circulation.

However, on quarterly basis, M0 increased by 4% in the December quarter, following a downturn in the previous three consecutive quarters. This was mainly driven by a seasonal pickup in both the currency in circulation and ODC's deposits by 7% to \$910 million and 3% to \$1,934 million respectively on the component side.

On the asset side, the annual fall in M0 was driven by CBSI's net foreign assets (NFA) and net domestic assets (NDA) in 2019. CBSI's NFA declined by 5% to \$4,581 million that mirrored the fall in both the foreign assets and foreign liabilities by 6% to \$4,706 million and 16% to \$125 million respectively. Whilst, the fall in NDA by 2% to \$1,722 million was driven by the widened net domestic credit by 10% to minus \$1,589 million as government drew down its deposits in the financial system. Meanwhile, capital accounts went up from \$135 million in 2018 to \$305 million in 2019.

Figure 5.1: Major drivers of Reserve Money



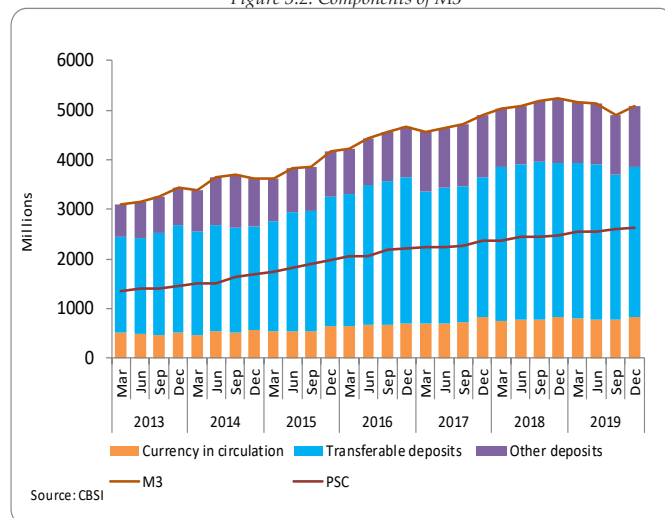
Narrow Money

Narrow money (M1) year on year growth declined by 2% to \$3,848 million from the 8% growth posted in 2018. This mirrored a decline in transferable deposits by 3% to \$3,020 million that offset the 0.1% rise to \$828 million in currency in active circulation. Quarterly, M1 increased by 4% in the December quarter due to a strong pickup in festive season demand for currency in circulation. Besides, transferable deposits also grew by 3% compared to the 7% fall in the third quarter of 2019.

Broad Money

Broad money (M3) decreased by 3% to \$5,082 million by the end of 2019 from the 7% year on year growth in the previous year. The fall mirrored the 2% fall in M1 and other deposits (saving and time), which decreased by 6% to \$1,234 million. On the sources side, the fall in M3 was due to a 5% decline in the NFA of the banking system to \$4,781 million that outweighed the increase in the NDA to \$366 million from \$240 million in 2018. The increase in NDA stemmed from a rise in the net domestic credit (NDC) and other items net respectively. The former by 23% to \$1,501 million and latter by 26% to \$227 million. The increase in NDC was mainly driven by credit to private sector by 6% to \$2,621 million despite a fall in net credit to nonfinancial public sector by 11% to minus \$1,121 million. Meanwhile, capital accounts recorded an increase of 18% to \$1,362 million that mirrored the improvement of the CBSI capital position from \$130 million in 2018 to \$304 million in 2019 combined with a 3% rise in ODCs' capital to \$1,058 million in 2019 respectively.

Figure 5.2: Components of M3

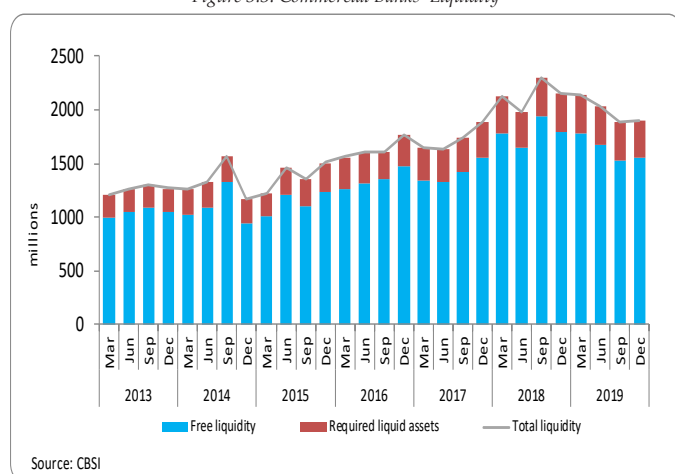


Liquidity

Total liquidity conditions in the banking system declined in 2019 by 12% to \$1,907 million, a turn around from the 14% growth in 2018. This was underpinned by the fall in CBSI's NFA position by 5% to \$4,581

million coupled with a decline in the net position of government by 15% to \$770 million. As a result, both excess and free liquidity fell by 15% to \$1,370 million and 14% to \$1,554 million respectively

Figure 5.3: Commercial Banks' Liquidity



Domestic Credit

Net domestic credit (NDC) of the banking system grew annually by 23% to \$1,501 million at the end of December 2019, much higher than the 5% growth observed in 2018. This outcome was supported by an increase of 6% to \$2,621 million in credit issued to the private sector along with the fall in the net credit to the central government (NCG) position by 11% to minus \$1,137 million. Increased credit to the private sector was on the back of the ODCs loans issued to other nonfinancial corporations of \$1,787 million, despite a 5% fall in loans to other resident sectors to \$808 million. Meanwhile, the downturn in NCG was underpinned by the drawdown of government deposits from the banking system at the end of 2019.

In terms of sectoral credit issued by ODCs, annual growth was at 5% to \$2,557 million in 2019, a slight increase from the previous year's growth of 4% to \$2,425 million. The main sectors driving credit growth were; Forestry by 26% to \$76 million, transport by 23% to \$184 million, distribution by 13% to \$558 million, personal loans which increased by 12% to \$695 million, and construction, which grew by 11% to \$494 million. Conversely, tourism, manufacturing, and professional and other services contracted by 12% to \$158 million, 20% to \$119 million and 13% to \$108 million respectively. Proportionally, personal loans held the largest share of credit with 27%, followed by distribution with 22%, construction with 19%, and the rest of the sectors with less than 10% each.

Table 5.1: Private Credit by sectors: (SBD\$millions)

Sectors	2018	2019				Percentage Growth	
	Q4	Q1	Q2	Q3	Q4	Q-on-Q	Year-on-Year
Personal	420	629	636	678	695	2%	12%
Construction	444	466	490	499	494	-1%	11%
Distribution	496	528	537	560	558	0%	13%
Communication	433	99	99	84	83	-1%	-38%
Tourism	179	175	166	162	158	-3%	-12%
Prof& other Services	125	123	129	106	108	2%	-13%
Transport	149	181	186	187	184	-2%	23%
Manufacturing	149	146	134	130	119	-8%	-20%
Forestry	60	61	53	63	76	21%	26%
Agriculture	13	13	15	17	15	-8%	18%
Entertt & catering	3	4	3	3	3	-6%	24%
Mining & Quaring	0	0	0	0	0	0%	0%
Fisheries	7	28	24	13	11	-13%	68%
Statutory Corporatration	45	41	41	44	40	-9%	-10%
Non- Resident	0	0	0	0	0	0%	0%
Private Fin. Institute	1	1	1	10	11	6%	904%
Central Government	0	0	0	0	0	0%	0%
Provincial Asse. &	0	0	0	1	0	-1%	-2%
Local Gov't							
Total	2,425	2,496	2,513	2,557		0.03%	5%

Note: Figure include loans issued by Commercial banks and Credit Corporation of Solomon Islands.

Credit issued as overdrafts declined while loans and lease financing expanded during the year. Overdrafts fell by 10% to \$224 million. Loans grew by 7% to \$2,306 million while lease financing expanded by 22% to \$27 million relative to the previous year.

Table 5.2: Private Sector Credit (ODCs) SBD Millions

	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19
Trade Bills	0	0	0	0	0	0	0
Over drafts	247	235	248	268	269	269	224
Loans	2,130	2,150	2,155	2,205	2,216	2,261	2,306
Lease Financing	13	19	22	24	28	27	27
Total	2,390	2,404	2,425	2,496	2,513	2,557	2,557
Total credit (excluding trade bills)	2,390	2,404	2,425	2,496	2,513	2,557	2,557

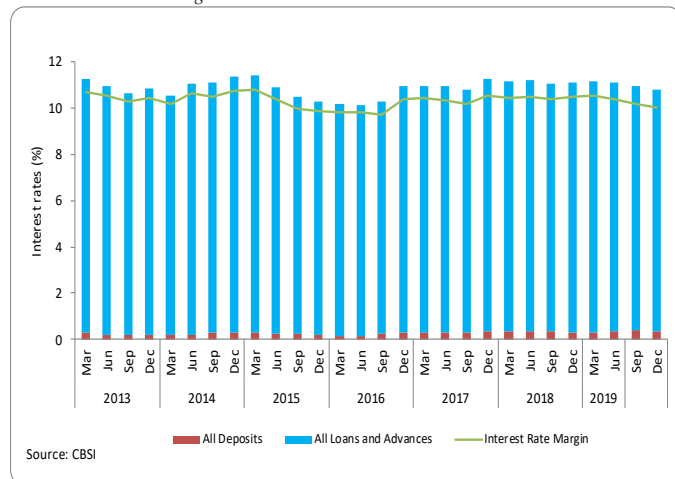
Source: CBSI

Interest Rates

The weighted average interest rate margin of ODCs receded further from 10.48 % in the previous year to 10.02% in 2019. This was led by the decline in the weighted average rate for lending, moving from 10.79% to 10.40%. Conversely, deposit rates increased from 0.30% to 0.38% during the year. The fall in lending rates was driven mainly by a decline in the lending

rates issued to these following sectors; transportation from 10.62% to 9.77%, manufacturing from 9.14% to 8.72%, Forestry from 15.31% to 13.33 %, fisheries from 18.37% to 16.01%, distribution from 11.82% to 10.70%, and Statutory corporations from 14.75% to 9.33%.

Figure 5.4 Commercial Banks' Interest rates



Other Financial Corporations

Net foreign assets of other financial corporations (OFCs) year on year expanded by 13% to \$332 million in 2019. The outcome emanated from increased foreign assets by 14% to \$369 million on account of non-residents' shares in foreign currency, growing by 45% to \$199 million. This was also supported by the growth in other deposits from non-residents by 9% to \$111 million. Meanwhile, net foreign liabilities increased notably by 26% to \$37 million by the end of 2019.

Furthermore, other financial corporation's NDA grew annually by 9% to \$2,990 million, the same growth rate recorded in 2018. Supporting this expansion was a 0.1% rise in NDC to \$2,723 million and an increase in

other Items Net (OIN) by 26% to \$563 million, along with a fall in capital accounts by 30% to \$295 million. Growth in NDC stemmed from increased credit to financial corporations by 4% to \$857, notwithstanding the decline in private sector credit by 2% to \$1,447 and a reduced net credit to the non-financial public sector by 1% to \$419 million. The downturn in PSC largely reflected the decline in loans issued in national currency to other nonfinancial corporations by 22% to \$105 million. On the other hand, the decline in credit to the non-financial public sector was driven by a fall in net credit to the central government by 2% to \$183 million.

Monetary Policy

The CBSI adopted an accommodative monetary policy stance in September 2019, easing the moderate tightening stance in March 2019. In determining this stance, the Bank took into consideration the slower economic conditions in the first six months, subdued outlook for growth and forecasted low inflation for the remaining part of the year.

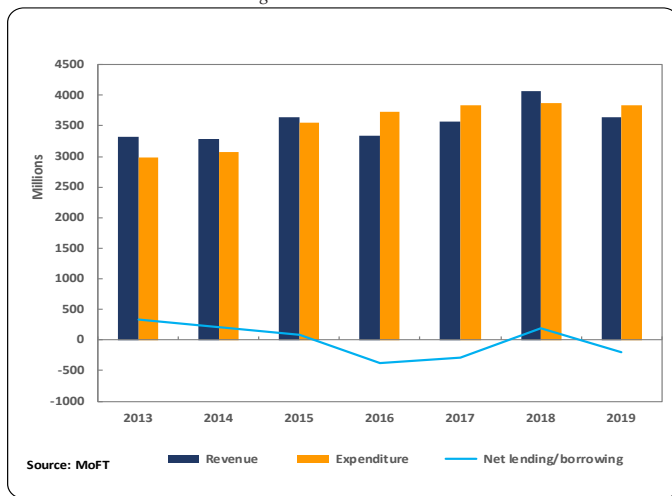
Monetary policy is managed through the Bank's policy instruments. This involves the cash reserve ratio and managing liquidity through open market operations (OMO). The cash reserve ratio is maintained at 7.5% of the total ODC's deposits. The stock of Bokolo bill issued remained at \$750 million with a weighted average yield (WAY) at 0.54% as in December 2019. The stock of treasury bills issued totaled to \$90 million by the end of December 2019, close to hitting the new borrowing threshold of \$100 million. Meanwhile, the WAY for 91, 181 and 365 days remained fixed at 4.49%, 1.12% and 1.96 % respectively at the end of December 2019. While there were no changes to the current exchange rate regime, the Solomon Islands dollar depreciated during the period.

Chapter VI. GOVERNMENT FINANCE

Overview

Two major events shaped budgetary outcomes in 2019. On the outset, the caretaker mode for government before the national general elections and the formation period limited government spending and its impact on the economy. By June, the fiscal position improved to a preliminary surplus of \$129 million from savings accumulated in the first six months. Secondly, fiscal revenues declined with log export duties falling on the back of sluggish demand for logs in the Peoples Republic of China (PRC), along with a slowdown in economic activity that further constrained revenue collections. Moreover, the uncertainties before and after the switch in the country’s diplomatic relations from the Republic of Taiwan (ROC) to PRC also affected operations. Consequently, the fiscal position turned around from the surplus in the first half to a deficit of \$331 million in the final six months of 2019. This brought the total annual fiscal balance to a deficit of \$202 million (2% of GDP), compared to \$191 million surplus posted in 2018. Meanwhile, the central government’s outstanding debt stock continued to rise on the back of additional external loan disbursements and the continued increase in domestic treasury bills issued.

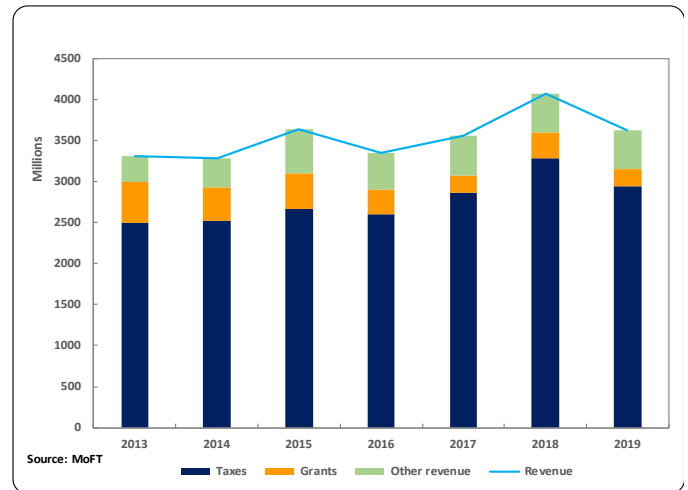
Figure 6.1: Fiscal balance



Revenue

Total revenue fell by 11% to \$3,633 million year-on-year compared to the 7% growth recorded in 2018. The outcome in 2019 mirrored lower tax and grant receipts despite a marginal increase in nontax revenue. Against the budget, total revenue underperformed by 13%.

Figure 6.2: Central Government Revenue



Tax revenue

Total tax revenue fell by 10% to \$2,942 million in 2019 driven by reductions across all tax categories. Against the budget, tax revenue fell short by 7%.

Tax on international trade and transactions, which constituted 42% of total tax revenue, contracted by 18% to \$1,237 million year-on-year. Reductions in both import and export duty, the former by 14% to \$613 million and the latter by 21% to \$624 million underpinned the year-on-year outcome. This tax category fell short by 7% against the budget.

Tax on income, profits, and capital gains fell by 3% to \$1,006 million year-on-year, 9% below the budget. The outcome was attributed to the decline in corporate tax by 9% to \$488 million despite an increase in PAYE by 3% to \$518 million. Tax on income, profits and capital gains comprised 34% of total tax revenue.

Tax on goods and services, which accounted for 22% of total tax revenue, declined by 5% to \$657 million in 2019, 2% lower than the budget. The slower growth came from declines in excise taxes, by 15% to \$198 million, and goods and services taxes, by 6% to \$400 million reflecting subdued economic activities in 2019. Meanwhile, property tax, which contributed only 1% of tax revenue, edged 1% lower to \$41 million year-on-year and fell short by 11% against the budget- driven by lower collections on withholding tax.

Grants

Total donor grant receipts fell to \$213 million from \$317 million in 2018, less than half of the 2019 budget. Australia remained the largest donor providing \$104 million (49%), although this was 33% lower than in 2018. This is followed by the PRC which provided around \$55 million (26%) and ROC with \$44 million (16%). The New Zealand Government and World Health Organisation (WHO) provided \$9 million and \$5 million respectively. Other small donors contributed \$6 million.

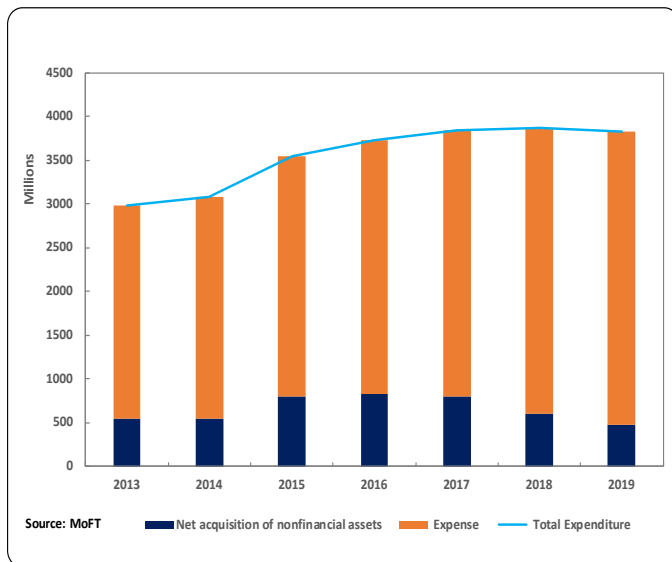
Non-Tax Revenue

Non-tax revenue slightly improved by 1% to \$477 million although this was 4% below the budget. This improvement was supported by property income which grew by 9% to \$310 million driven largely by higher proceeds from fishing license fees. Conversely, sales of goods and services contracted by 12% to \$165 million. Meanwhile, nontax revenue contributed 13% of total revenue.

Expenditure

Total government expenditure declined by 1% to \$3,834 million year-on-year and was 14% below the budget. The year-on-year outcome reflected a notable cut in development spending by 28% to \$473 million despite an increase in recurrent expenses by 4% to \$3,362 million.

Figure 6.3: Central Government Expenditure



Compensation of Employees

Payroll spending grew by 5% over the previous year to \$1,393 million, slightly above the annual budget by \$5 million. The year-on-year growth mirrored increases in wages and salaries, by 5% to \$1,316 million and employer’s contributions to the Solomon Islands National Provident Fund (SINPF), by 6% to \$77 million. Compensation of employees made up 41% of the recurrent expense.

Purchase of Goods and Services

Consumption spending, which represented 49% of recurrent outlays, rose by 6% to \$1,644 million in 2019 and was below the budget by 11%. The year-on-year outturn reflected increases in the following major spending items; other consumption items which increased by 10% to \$653 million, utility charges up by 10% to \$118 million, public servants’ annual leave by 11% to \$70 million whilst consultation fees surged from \$53 million to \$92 million. Similarly, office rent expanded by 19% to \$40 million, conferences and workshops, from \$24 million to \$38 million while maintenance costs increased by 19% to \$143 million. In contrast, training related spending, particularly government tertiary scholarships and other training declined by 7% to \$421 million during the year.

Grants

Total grant transfers to other government units, which accounted for 3% of total recurrent expenses fell to \$91 million, less than half of the actual in 2018. This mirrored the decline in other services grants from \$126 million to \$6 million¹. On the other hand, transfers to provincial governments surged by 23% to \$11 million while fixed asset grants picked up by 2% to \$66 million during the year. Meanwhile, grants to the Solomon Islands National University (SINU) remained at \$22 million as in 2018. Against the budget, total grant transfers were below by 15%.

Subsidies

Subsidies increased further in 2019 by 11% to \$33 million, outpacing the budget by \$19 million. Much of the increase stemmed from the government’s assistance to the franchise shipping scheme which provided shipping services to remote areas throughout the country.

Social Benefits

Social benefits, which contributed only 1% of total recurrent spending, contracted by 12% to \$47 million in 2019 but exceeded the budget by 13%. This actual outcome was driven by lower spending on pensions and gratuities, and workers’ compensation; the former fell to \$22 million from \$41 million in 2018 and the latter by 22% to \$0.7 million. On the other hand, long service benefits doubled to \$24 million against the preceding year.

Other Payments

Other payments, which constituted 4% of total recurrent charges, rose notably from \$48 million in 2018 to \$133 million in 2019. The year-on-year increase was largely driven by higher spending on subvention grants, community service obligation (CSO) and other payment items. Subvention grants grew by 4% to

¹ The notable decline was due to reclassification

\$168 million, CSO from \$14 million to \$33 million and other related spending from \$23 million to \$51 million. Conversely, grants to overseas missions dropped by 5% to \$27 million during the year. However, other payments fell below the budget by 66%.

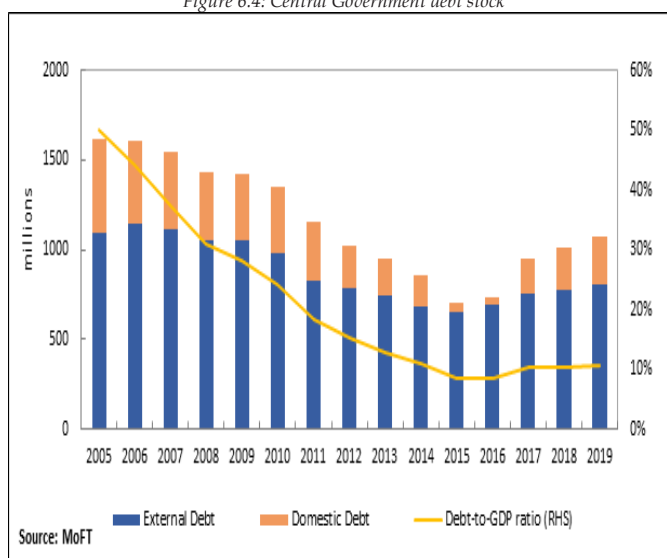
Acquisition of Nonfinancial Assets

Acquisition of non-financial assets dropped by 28% to \$473 million in 2019, 27% below the budget. This outcome mirrored declines in fixed assets by 28% to \$458 million and non-produced assets by 20% to \$15 million. The National General Election (NGE) and the formation of the new government in 2019, in part, delayed implementation of projects. As a share of total government expenditure, capital spending contributed 12%.

Debt Stock and Servicing

Central Government’s outstanding debt stock rose further to \$1,074 million in 2019 from \$1,016 million in 2018, maintaining the upward trajectory since 2016. Increases in both the external and domestic debt stock, by 4% to \$802 million and 11% to \$273 million respectively underpinned the growth in 2019. The increase in external debt was attributed to additional loan disbursements and depreciation of the SBD against both the Special Drawing Right (SDR) and United States Dollar (USD). The growth in domestic debt stemmed from increases in auction treasury bills issued. Consequently, the debt-to-GDP ratio rose to 11% from 10% in 2018, debt-service-to-domestic revenue, to 2% from 1%, while debt-service-to-exports of goods and services remained at 1% as in 2018.

Figure 6.4: Central Government debt stock



Total debt service increased to \$63 million from \$51 million in 2018. External debt service amounted to \$51 million, of which \$42 million was on principal repayment and \$9 million on interest payment. By holders of foreign debt, multilateral creditors accounted for 92% (\$741 million) of the total external debt while

bilateral creditors constituted 8% (\$61 million). By currency, 90% of external debt is denominated in SDR, 9% in USD and 1% in EURO.

On domestic debt, treasury bills issued rose to \$88 million from \$60 million in 2018, following the implementation of the new borrowing threshold of \$100 million. Meanwhile, domestic debt servicing rose to \$11 from \$8 million in 2018 as the government started repaying the interest component of the Solomon Islands National Provident Fund bond in 2019.

2020 Budget Outlook

Budget pressures eased in 2018 but resurfaced in 2019, eroding fiscal buffers. With revenue slowing down and expenditure pressures mounting, achieving a balanced budget in 2020 will be a challenge, more so with the emergence of the corona virus in Q1 that could put the budget and finances under pressure.

The 2020 budget theme is “Together, Towards Growing Our Economy”. The balanced budget is set against three guiding principles; strengthening the macroeconomic environment and fiscal position, improving the quality of spending, and ensuring continued support for domestic economic growth.

Total revenue is expected to decline in 2020 by 7% to \$3,942 million compared to the 2019 revised budget. Tax revenue and grant receipts are expected to weaken and nontax revenue to remain buoyant in 2020. Tax on income, profit, and capital gains is projected to slip by 7% to \$1,067 million. Similarly, tax on international trade and transactions is forecast to drop by 11% to \$976 million as logging tapers. These will offset expected gains in goods and services by 9% to \$976 million supported by tax hikes on rice, sweets and sugary beverages. Nontax revenue is estimated to improve by 2% with improved fishing conditions in 2020. Grant receipts are projected to be lower by 33% reflecting uncertainties in donor funding. However, the 2020 total revenue forecast represents an increase of 6% when compared to the 2019 preliminary actuals.

Consistent with the slowdown in revenue, the government is committed to ensuring fiscal consolidation. Total expenditure is expected to decline by 5% to \$3,941 million against the 2019 revised budget. Recurrent expense is estimated to fall by 5% to \$3,083 million with payroll and other charges capped, no new bids accepted in 2020. Conversely, development spending is expected to pick up by 4% to \$627 million against the 2019 revised budget. Meanwhile, the 2020 estimated total expenditure declined by 2% when compared to the 2019 preliminary actuals.

The central government’s debt stock has risen since 2016 to finance priority projects. Approved major projects so far include; Tina River Hydro Power

Project, Undersea Optic Fibre Internet Cable, now fully implemented, Solomon Islands Road and Aviation Program (SIRAP), and Access to Renewable Energy project. These projects when fully drawn will raise the debt-to-GDP ratio to around 28% of GDP. The government has set a new threshold of \$100 million on treasury bills issued. The 2020 annual borrowing limit is \$300 million.

Budget risks; 2020 and beyond

Two foreseeable budget pressures are imminent. The government's contribution towards the 2023 Pacific Games (PG23) poses the greatest risk to the budget outlook. The total cost of the PG23 is estimated at \$1,586 million², with over 60% (\$950 million) to be funded by donors. It is binding on the government to finance 36%

(\$550 million) of the total cost. To meet its contribution, the government must commit \$110 million each year from 2019 to 2023. However, this commitment has not been fully allocated for in the 2019 and 2020 budgets. The outstanding will accumulate in 2020 and beyond putting additional pressure on government finances.

The second risk relates to budget pressures emanating from possible coronavirus (COVID-19) outbreak in the country. Although the government has committed some funding to fight the coronavirus (COVID-19), additional funding could be required if a fallout becomes an epidemic. This could hurt economic growth, stifle domestic revenue collection and further amplify expenditure pressures.

² Budget estimates are provided by the National Hosting Authority for 2023 Pacific Games

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