CENTRAL BANK OF SOLOMON ISLANDS

MONETARY POLICY STATEMENT
September 2020

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1. OVERVIEW

The Coronavirus-2019 pandemic (Covid-19) has been and remains the most significant drag on the global economy and society in recent memory. Due to its deep and widespread impact, global economic growth is projected to fall by -4.9% in 2020 with many countries slipping into recession.

The pandemic's impact and related lockdowns on most forms of economic activity has meant that consumer demand has waned and as such global inflation will remain muted for the year. Although, commodity prices have slightly picked up and oil prices despite sliding down have since returned to moderate levels.

As predicted in the CBSI's April revised outlook for the impact of Covid-19, the country went into a recession in the second quarter of 2020. Outturns for the first six months of the year show significant falls in the real economy; productive commodities, manufacturing and most services, aside from health and communication.

Likewise, the monetary sector contracted with falls in money supply, liquidity and private sector credit. Sectors driving the fall in lending included construction, tourism and transport. On the other hand, reserve money slightly picked up due to the rise in donor related net foreign assets.

External conditions meanwhile improved on account of appropriate and considerable donor assistance to support the government's Covid-19 response measures. As such, the current account turned surplus as imports of goods and services declined and secondary income improved. Moreover, the country's gross foreign reserves grew by 12% and represented a comfortable 13 months of import cover. Government's response to the pandemic, particularly to contain spending amidst a fall in revenue, along with the support of development partners has ensured that the fiscal deficit was narrowed to $32 million in the year to June. This reflects the 16% fall in total expenditure against the 2% reduction in revenue. Moreover, the incurring of new debt as part of the stimulus measures saw a pick up in debt levels, though still below mandated thresholds.

Despite the expectations for consumer prices to fall with the fall in demand and oil prices, headline inflation outturns shot up to 5.7% in June 2020 due to the surge in the betel nut index. Nonetheless, core inflation eased considerably to 1.2% reflecting waning consumer demand.

Amidst the grim situation brought about by the pandemic, real GDP growth in the Solomon Islands economy is projected to fall by around -3.9% in 2020, as most sectors are negatively affected both by falling demand and the health containment measures. Nevertheless, should the Covid-19 situation stabilize, growth should improve by 2% in 2021.

Over the medium term, real GDP is forecast to grow on average by 3.5% as the big-ticket projects are rolled out. Although growth could dip in 2024 as the economy emerges in the aftermath of the pacific games and the other projects. Appropriate polices should therefore be in place to mitigate this anticipated outcome.

Nonetheless, there are significant downside risks to this near to medium term outlook that are primarily hinged on the uncertainty on the duration and extent of the Covid-19 situation both in the country and amongst key trading partners.

2. INTERNATIONAL ECONOMIC DEVELOPMENTS

The IMF's global economic growth forecast for 2020 has been revised downward in June to -4.9% from 2.9% in the April WEO forecast. This depressed outlook was predominantly induced by the lingering negative impacts of the coronavirus pandemic (Covid-19) on economic activities around the world in the first half of 2020. Although recovery is gradual in many advanced economies, the second wave of infections, its prolonged adverse effects and the nonexistence of a vaccine may further hinder the recovery process.

The global lockdowns and economy wide disruptions has caused a majority of countries to plunge into recession in the second half of 2020. Globally, governments have implemented $11 trillion worth of policy responses to mitigate the impacts of COVID-19 for both health and economic stimulus measures. However, persistent United States (US)-China tensions, issues amongst oil producing countries and social unrest could further weigh heavily on the global economy[1].

In the near term, global growth is projected to be subdued at 5.4% for 2021, underpinned by gradual pick up in consumption and investment activity.

Growth in both the advanced economies and the emerging markets have also been further reduced to -8.0% and -3.0% from -3.0% and -1.0% respectively for 2020. These deep downturns are underpinned by deeper hit to economic activity and larger spillovers from weaker external demand. The forecast for both economic groups in 2021 is for growth to strengthen to 4.8% and 5.9% respectively, following a rebound forecast for China and other regions.

Meanwhile, China is recuperating from a sharp contraction in the first quarter to an annual growth rate of 1.0% for this year, whilst the US economic growth is expected to contract by 6.1%, 7.9% below the previous forecast.

In terms of the regional front, the Australian economy is projected to shrink by about -6% in 2020 elicited by widespread uncertainty about the prolonged effects of Covid19, depressed demand and rising unemployment. A rebound in growth is projected for 2021 by around 5% and 4% in 2022[2] . As for New Zealand, annual GDP is projected to fall by -5.8% in 2020, a smaller decline than earlier expected, before recovering to 5.6% in 2021 as economic activities pick up[3].

2. 1 : Global Inflation

Global inflation and core inflation remained muted in the first half of 2020 across both advanced and emerging market economies. This reflected persistent weak demand triggered by lower commodity prices, especially fuel prices. Average inflation in advanced economies is projected to fall to 0.3% this year from 1.4% in 2019. Likewise, inflation in emerging economies is expected to ease by 70 basis points to 4.4% in 2020.

In terms of our regional neighbours, inflation outcomes in Australia and New Zealand remained low and stable in 2020. Australia's headline inflation declined by -0.3% in the June quarter from 0.3% in April, triggered mainly by the fall in petrol prices and free education in the pre-school category. However, inflation is expected rise in September with the reintroduction of Pre-school fees and the gradual increase of fuel price over the period in the second half of the year. Inflation is expected to remain below 2% for the coming years[2]. In New Zealand, headline inflation hovered around 1.5% at the end of June, 2.5% drop from the March level, however projection for the second half of 2020 is expected to remain below 2% following the decline in fuel prices and non-tradable goods[3].

2.2.Global commodity prices

Based on IMF's June WEO data, the commodity price index rebounded by 8% to 91.4 index points. This outcome reflected improvements seen across both fuel and non-fuel commodities during the quarter. Non-fuel commodities index increased by 2% to 108.2 index points, energy index grew by 21% to 66.9 index points, and the petroleum index picked up by 30% to 72.3 index points. Similarly, tapis fuel price, the main imported fuel for the Solomon Islands firmed up from USD 22.85 in April to USD 43.9 per barrel at the end of July 2020[4].

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

[2] Reserve Bank of Australia Statement on Monetary Policy August 2020.

[3] Reserve Bank of New Zealand Monetary Policy Statement August 2020

[4] Bloomberg Energy, August 2020.

3. DOMESTIC ECONOMIC DEVELOPMENTS

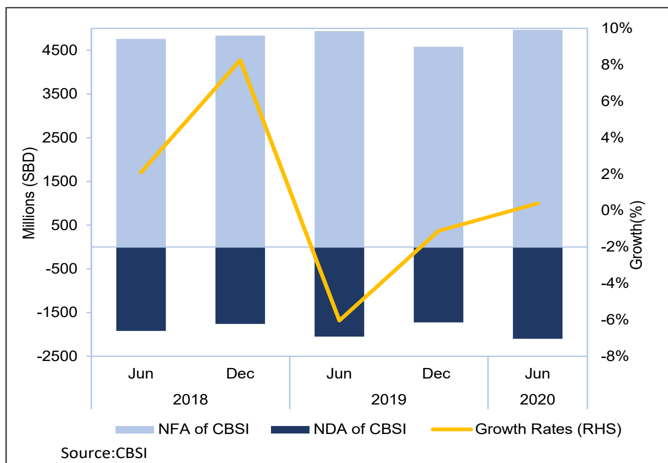
3.1. Monetary Conditions

Monetary conditions weakened amidst the slower economic activities across the first six months of 2020. Reserve money(M0) picked up marginally, whilst broad money(M3), private sector credit (PSC) growth, and total liquidity all contracted over the period.

3.1.1. Reserve Money

Reserve money (M0) slightly increased by 0.4% to $2,864 million in the first six months of 2020. The uptick against December 2019 was driven by an increase in both currency in circulation and commercial bank call accounts by 0.4% to $914 million and 1% to $1,947 million respectively. On the sources side, this outcome reflected the increase in CBSI's net foreign assets (NFA) by 8% to $4,967 million and further widening of the CBSI's net domestic assets (NDA) by 22% to -$2,097 million.

Figure 1: Drivers of Reserve Money



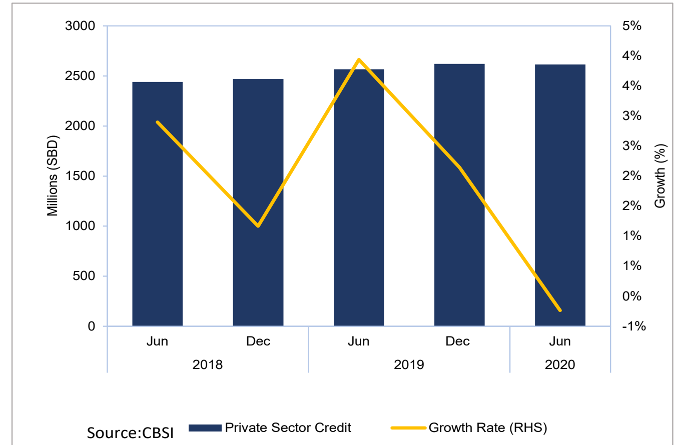
3.1.2. Money Supply

Broad Money (M3) declined by 0.3% to $5,069 million against December 2019, driven by a fall in other deposits that outweighed the increase in narrow money (M1). On the sources side, this downturn mirrored the deterioration in the NDA of the banking system; from $366 million in December 2019 to -$222 million. Meanwhile, NFA of the banking system pickup notably by 12% to $5,347 million.

3.1.3. Credit Conditions

Private Sector Credit (PSC) fell by 0.2% to $2,615 million in the first six months of 2020. This stemmed from a decline in ODCs' lending by 1% to $2,599 million. The sectors that contributed to the downturn include entertainment & catering, communication, fisheries, transport, tourism, forestry, private financial institution, and construction. Nevertheless, credit issued to agriculture, distribution, professional & other services, manufacturing, and personal increased over the same period.

Figure 2: Credit to Private Sector



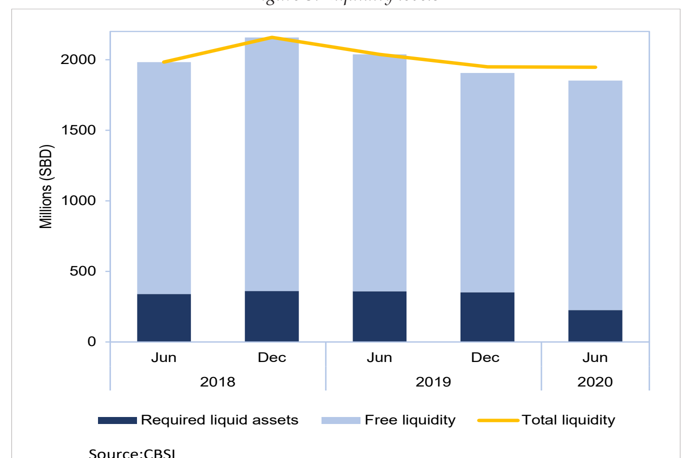
3.1.4. Interest Rate Trends

The ODCs' interest rate margin widened to 10.34% in June 2020 from 10.02% in December 2019. This reflected an increase in both the average weighted deposits rates from 0.38% to 0.47% and lending rates from 10.40% to 10.80% respectively over the same period. The upturn in the lending rates mirrored increased across major credit recipient sectors.

3.1.5. Liquidity Levels

The total level of liquidity in the banking system dipped by 0.1% to $1,497 million in June 2020 against $1,450 million posted in December 2019. This outcome mirrored the deterioration of the CBSI's NDA position that is notably driven by government deposits accumulated across the first six months of 2020. Despite the fall, both excess and free liquidity increased by 5.1% to $1,440 million and 4.6% to $1,625 million respectively over the same period.

Figure 3: Liquidity levels



3.1.6. Open Market Operations

The stock of Bokolo Bills(BB) issued at the end of June 2020 declined to $660 million against $750 million recorded in December 2019. This fall reflects the Bank's expansionary monetary policy stance to

ease the impact of Covid-19 on the financial sector. Additionally, the weighted average yield widened by 2 basis points to 0.56%. Meanwhile, the stock of treasury bills issued stood at $83 million by the end of June 2020 with less space left before reaching the threshold of $100 million. The interest rates for 91days remained unchanged at 0.49% as of December 2019. Whilst, for 182 days and 365 days, the interest rate fell by 1 basis point to 1.11% and by 2 basis points to 1.96% respectively.

3.1.7. Other Monetary Policy Action

In view of the unprecedent situation, CBSI took a variety of expansionary policy actions. In June, the Cash Reserve Requirement (CRR) was cut by 2.5 percentage points to 5% in June. The CRR is a direct monetary policy instrument that requires commercial banks to keep a certain portion of deposits with CBSI. A reduction means banks can have more available liquidity for operations.

Moreover, the Bank implemented a new repurchase (repo) facility for participating commercial banks in September. It is also on standby and prepared to purchase government bonds in the secondary market, and is progressively developing guidelines for an Export Finance Facility to assist exporters in the country.

Additionally, as a policy mitigation and financial inclusion measure, the Bank in July launched *The Solomon Islands Digital Marketplace Project*. This is a partnership with the United Nations Development Programme and the United Nations Capital Development Fund - Pacific Financial Inclusion Programme, along with the Bulk Shop and participating youths to provide avenues for a Covid-19 response and recovery in the local market, particularly on supply chain measures and possible digital solutions.

3.2. Domestic Conditions

Domestic economic activities contracted in the first six months of 2020 due to the impact of Covid-19. A state of public emergency was declared on 25th March, and the government imposed strict measures and guidelines to stop the spread of the pandemic in the country. These public health containment measures and travel restrictions have affected household spending, business investments, and trade. As a consequence, the performance of key sectors plunged beginning in April.

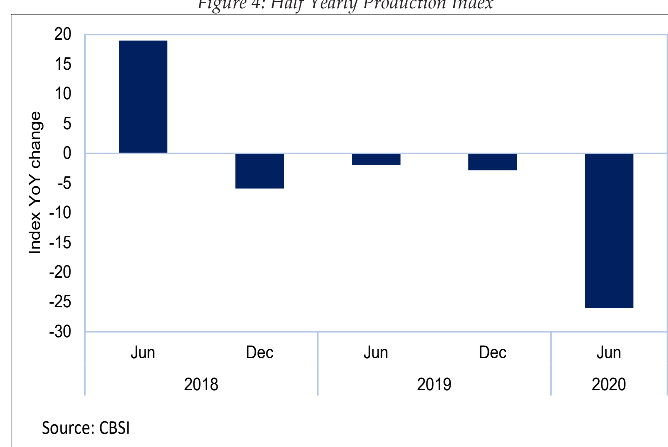
3.2.1. Economic Growth

The real GDP growth for 2019 was estimated at 1.2% and in the March 2020 Monetary Policy Stance was expected to modestly grow at 2.0% in 2020 under an assumed impact of Covid19 limited only to major trading partners. However, with the rapid spread of Covid19 globally and the WHO declaration of a global pandemic, CBSI revised down the 2020 growth forecast in April to a recession. With the high uncertainties of the magnitude impact, the bank estimated growth to fall between -3% and -5%. In the first six months of this year, the economy deteriorated as projected with overall production and manufacturing dropping to shallow levels, and other sectors such as hotels and air transport came to a standstill given travel restrictions and the sudden stop in tourist arrivals.

3.2.2. Production Index

Production plunged in the first half of 2020 with the CBSI production index recorded the lowest index of 79 points, a slump of 26 points (see Figure 4). This negative outcome was largely driven by significant drop in the volume of round logs, fish catch, and cocoa – the three commodities that comprised more than three-quarters of the total country's exports.

Figure 4: Half Yearly Production Index



Year-on-year, round logs fell by 10% due to lower demand from China and general slowdown in logging activity. Fish catch dropped by 50% and cocoa by 40% due to unfavourable weather conditions and logistics disruptions following the Covid19 measures. Meanwhile, palm oil remained the same, and copra production picked up by 77% on the back of higher copra prices. It was fortunate that there were no positive Covid19 cases in the country, otherwise output across sectors would have been affected with lockdowns and other strict measures being imposed.

3.2.3. Manufacturing

Manufacturing activity declined in the first half of 2020 as indicated in the manufacturing index that dropped 14% to 235 points compared to the same period in 2019. This was driven by both manufacturing for local consumptions and exports, indicating weak consumption and investments in the domestic market and also limited supply of fish to the tuna cannery resulting in lower export shipments.

3.2.4. Other Sectors

The other sectors of the economy have also shown weak performance in general except for the health and communication sectors. Government expenditure to the health sector increased significantly by around 15% associated with Covid19 response spending while the communication index almost doubled to

413 points attributable to higher internet usage during the first six months. Tourist arrival decreased four-folds affecting revenue for the aviation, hotels and tour operators. Investments were subdued in the first six months with cement imports down by 13%, FDI applications by 38%, and the delayed commencement of constructions for the national projects. Moreover, electricity production and sales dipped by 1% and 2% respectively, reflecting lower usage and demand for energy. Imports of food and beverages also decreased by 2%, and imports of passenger vehicles declined 26%, implying weak consumption in the domestic economy.

3.2.5. Employment

The labour market worsened in the first six months. SINPF members' contribution dropped by 2% to a total of 59,605 (active and slow active) contributors. This is a loss of 1,038 contributors for the first half of the year and owed to laid-off workers from hotels and other firms negatively affected by the Covid19 pandemic. Moreover, vacancies advertised in print media have also declined 13% indicating slower demand for employment. Given Covid19 negative impacts on businesses' financial positions, some firms have reduced hours for workers while others halt planned recruitments suggesting the job market has faltered over the period.

3.3. External Conditions

The Balance of Payments (BOP) position turned around to a surplus at 4% of GDP ($441 million) during the first half of the year from a revised deficit of -3% of GDP (-$370 million) in the second half of 2019. This marked outcome came from the improvement of the current account amidst a relative fall in the capital and financial accounts. Accordingly, the gross foreign reserves surged over the period.

On an annual basis, the 4% of GDP BOP position in June improved from the 1% of GDP position in the same period in 2019.

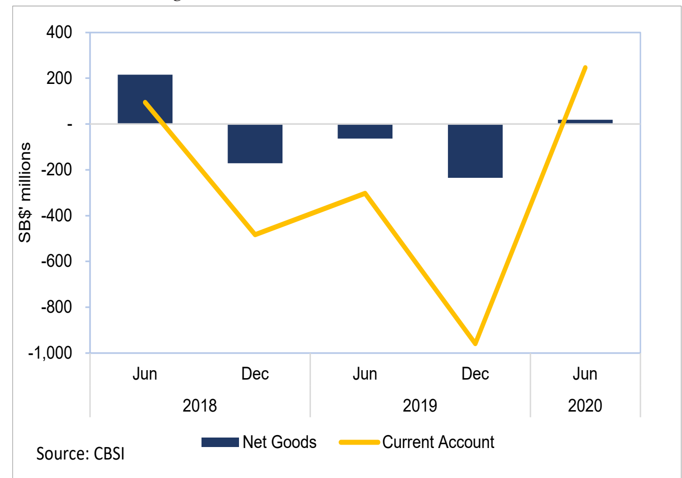
3.3.1. Current Accounts

The current account turned around to a surplus of $247 million from a revised $959 million deficit in the second half of 2019. This was driven by a significant increase in the secondary income account reflecting donor support towards Covid-19 responses, coupled with positive increases in the trade in goods and services, and a turnaround in primary income.

The trade in goods outturn was due to a marginal increase in exports by 1% to $1,762 million in the first six months of the year, particularly from the higher value of forestry, agriculture and mining against a fall in imports by 11% to $1,754 million. The drop in imports was driven by mineral fuel, crude materials, chemicals, machinery and equipment and miscellaneous imports.

During the first half of the year, the services deficit improved to $379 million from $647 million deficits as service payments dropped. Primary income likewise turned around to a surplus of $192 million from a $181 million deficit. While, secondary income more than tripled to a surplus of $426 million surplus against the previous period.

Figure 5: Trade and Current Account Balances



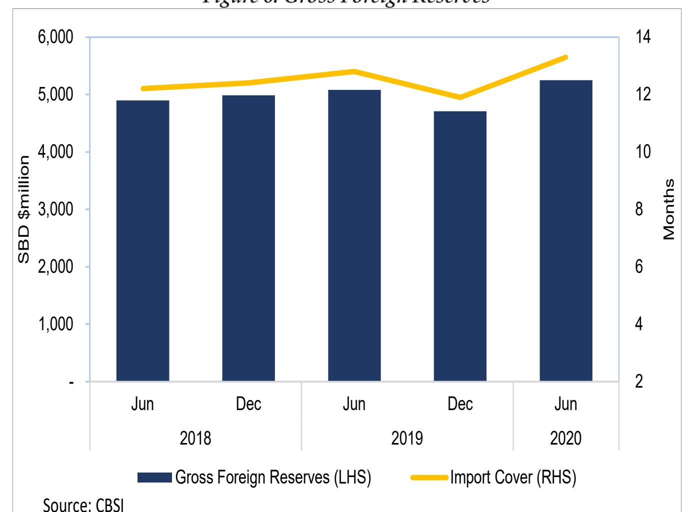
3.3.2. Capital and Financial Account

On the contra side, the 'capital and financial' account surplus went down by 39% to $255 million. This was due to fall in donor capital grants to $281 million, and net financial account which recorded a net outflow of -$26 million. The result in the capital account is associated with slow down and delays in donor capital projects due to the Covid19 pandemic (that was offset with more grant support in secondary income). While the outcome in the financial account was due to the fall in investment flows and the increase in foreign currency holdings by commercial banks.

3.3.3. Foreign Reserves

With the improved current account balance surplus driven mainly by inflows from donor support for Covid-19 measures, the gross foreign reserves increased by 12% to $5,250 million at end June 2020. This level of reserves is equivalent to around 13.3 months of import cover.

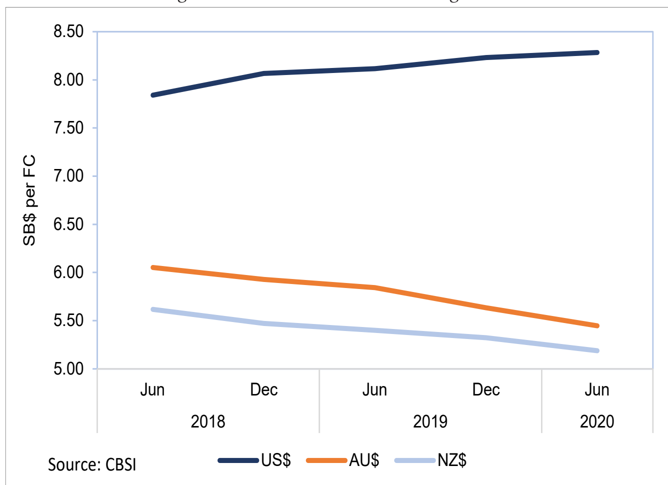
Figure 6: Gross Foreign Reserves



3.3.4. Exchange Rate

Global currency movements particularly the strengthening US dollar (USD) led to the Solomon Islands dollar (SBD) falling by 1.8% against the Trade Weighted Basket to 113.9 points. Against the key bilateral currencies, the SBD slid against the USD by 0.6% to $8.28 per USD. On the other hand, the SBD appreciated against the Australian dollar and New Zealand dollar by 3.4% to $5.45 per AUD and 2.6% to $5.19 per NZD respectively.

Figure 7: Nominal Bilateral Exchange Rates

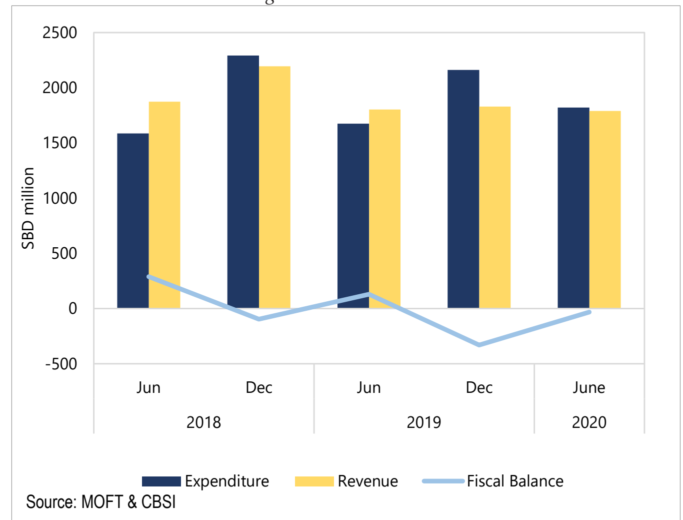


The country's Nominal Effective Exchange Rate appreciated by 1.5% to an index of 118.0. Moreover, the Real Effective Exchange Rate on average appreciated by 4% during the period, reflecting the inflation differentials between the country and its trading partners.

3.4. Fiscal Conditions

The government took early and decisive actions to prevent COVID-19 entering the country and avoided, at least for now, what could have been the worst health-induced economic crisis yet in the country. However, the necessary measures implemented to contain the pathogen's spread abroad and at home dented economic activities and strained fiscal operations in the first half of 2020. Revenues from log exports and domestic sources declined amid spending pressures to strengthen public health systems and revamp the flagging economy. Confronted with this dual challenge, the government contained spending and reallocated its resources to essential services only, particularly in the second quarter of 2020. Accordingly, the fiscal deficit narrowed to -0.3% of GDP (-$32 million) in the first six months of 2020 from a -3% of GDP position (-$331 million) in the second half of 2019. Meanwhile, the debt stock surged by 15% to $1,225 million in the six months to June alone, equivalent to 10% of GDP, from borrowing related to Covid-19.

Figure 8: Fiscal Balance

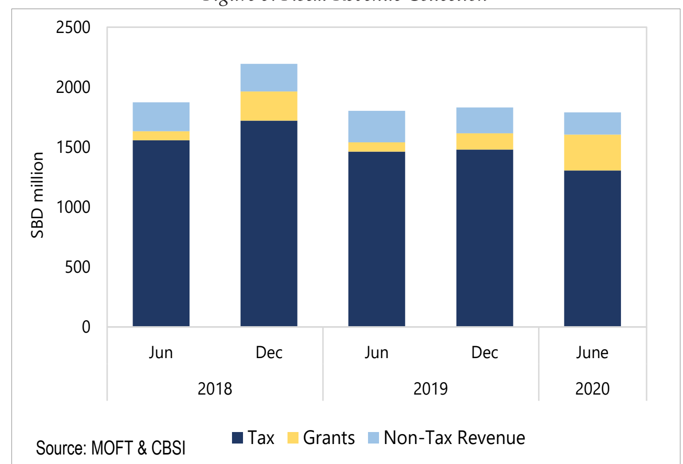


3.4.1. Revenue

Total revenue fell by 2% to $1,789 million in the first six months of 2020 driven by muted tax and non-tax collections offsetting a notable increase in grant receipts. This level was 12% below the budget and 1% lower than in the same period last year.

Tax receipts fell by 12% to $1,305 million in the first half of 2020, driven by reductions in all major tax categories. Compared to the budget and the same period in 2019, tax revenue was lower by 15% and 11% respectively. Non-tax revenue shrank by 14% to $185 million as revenue from fishing license fees ebbed. This level was 30% lower year-on-year and 28% below the budget. Conversely, grants increased twofold to $299 million in the first half of 2020 and tripled the amount received in the same period in 2019. This followed large donor support provided to cushion the impacts of the COVID-19 pandemic and finance long-term infrastructure development.

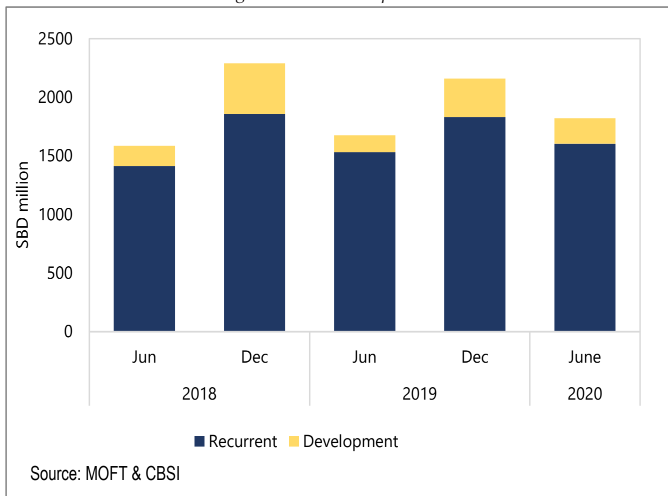
Figure 9: Fiscal Revenue Collection



3.4.2. Expenditure

Total expenditure contracted by 16% to $1,821 million in the six months to June 2019. This outcome reflected actions taken to contain and reallocate spending towards COVID-19 containment measures and stimulus spending. Compared to the budget, expenditure was 18% lower but 9% higher year-on-year. Recurrent expense, which accounted for over 80% of total expenditure, contracted by 12% to $1,603 million over the review period. Declines in goods and services and 'other' spending largely underpinned the fall in expense. Conversely, grants to other government units and payroll firmed up, the latter reflecting extra allowances paid to frontline staff, mainly police and health workers. Capital outlays plunged by 34% to $218 million in the first half of 2020 driven by spending cuts on fixed assets. This outturn was less than half the budget but twice the amount spent in the same period in 2019.

Figure 10: Fiscal Expenditure



3.4.3. Public Debt Stock

The Central Government debt stock rose by 15% to $1,225 million in the first half of 2020 driven by domestic and external borrowing related to COVID-19. External debt increased by 5% to $841 million underpinned by concessional loans contracted mainly from ADB and the World Bank. Domestic debt surged by 41% to $385 million from domestic bonds issued to state-owned enterprises and the National Provident Fund. By proportion, external debt's share of total debt shrunk to 65% from 74% in December 2019 as the domestic debt's stake increased from 26% to 31%.

3.5. Inflation Developments

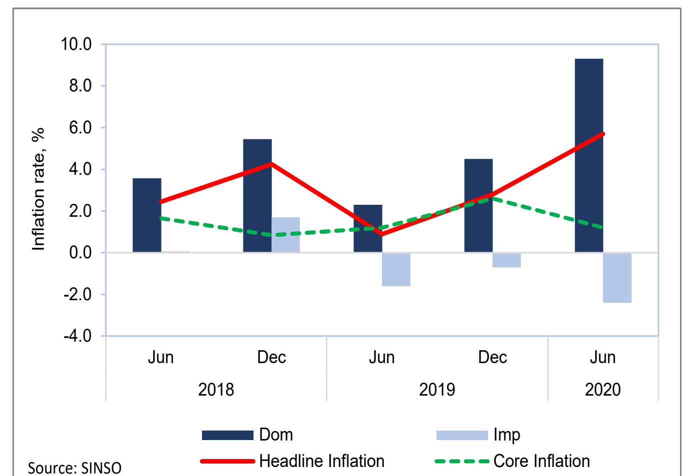
Headline inflation doubled from 2.8% in December 2019 to 5.7% in June 2020, a record high since 2014.

An in-depth analysis of the headline inflation showed that betel nut was the sole contributor to the sudden jump. As part of the Covid19 health measures, the government at the end of March banned betel nut markets in Honiara that limited stocks and could have affected data collection. Combined with the supply side impacts of the rainy season, this led to the tripling of the betel nut index and driving up of domestic inflation.

Domestic inflation more than doubled from 4.5% in December 2019 to 9.3% in June 2020. On the other hand, imported inflation remained negative at -2.4% from -0.7% on the back of lower world prices for fuel and food following the global recession. Meanwhile, core inflation eased to 1.2% in June 2020 from 2.6% in December 2019, reflecting reduced prices of non-volatile items. The lower core inflation indicated a depressed demand which was consistent with the subdued local economy. The spike in headline inflation, therefore, suggested that that the pressure on inflation in the first five months of the year was mainly a supply-side factor.

With respect to the surge in the betel nut index, alternative betel nut price calculation methodologies suggest a more measured inflation rate of around 3.6% at the of the half year period[5]. Moreover, the weak economic conditions and depressed demand is evident with the gradual fall in other major consumer price groups such as in transport, energy and food, and thus a much more muted price environment.

Figure 12: Inflation Developments



[5] This lower rate scenario incorporates CBSI betel nut prices and is purposely for economic analysis.

4. DOMESTIC ECONOMIC OUTLOOK

4.1. Real Economy

As anticipated, the negative impact of Covid-19 has led the forecast for real GDP growth for this year to fall to -3.9%; within the Bank's April forecast range of between -3% and -5%[6]. Aside from health and communication, almost all sectors in the real economy are expected to contract owing to the Covid-19 response measures or due to depressed global market conditions.

The most affected industries due to the pandemic and significantly driving down growth are transport, tourism, manufacturing, construction and forestry. Tourism from overseas markets in particular has totally stopped. So alternate approaches such as the promotion of domestic tourism activities, scenic air tours within the country, take-out food and drinks services at hotels and Covid-19 evacuation flight charters could provide some form of market driven relief for the sector.

The outlook for 2021 is rather more sanguine for real GDP to slowly recover to 2.0%, although this very much depends on the regional Covid-19 situation to stabilize. Driving this growth will be the anticipated recovery in agriculture, fisheries, wholesale retail and tourism. The construction of the key national projects, once they start are also expected to significantly drive economic activity.

Over the medium term (2022 – 2025), growth is projected to further pickup to an average 3.5%. In particular, amidst the boom from project related construction, and the pacific games related spinoffs to transport and hotels, growth will hover around 5% to 6% in 2022 to 2023.Post-games and with the scaling down of construction, growth is expected to dip considerably to only around 1% in 2024. Such growth deceleration typically occurs after a major event or culmination of a major construction project as also experienced in the region in previous years. The onus is therefore on policy makers to strategically plan ahead and put in place measures that would provide alternative sources of growth to mitigate the anticipated slowdown.

With the unprecedent nature and uncertainty regarding the duration of Covid-19, there are numerous downside risks to this near to medium term forecast. One is the potential for scarring of sectors such as tourism that would take years to return to pre-Covid levels. Additionally, depressed consumer demand and a further reduction in log shipments either from lower supply in the country or weaker demand in China are other overriding risks.

In acknowledging the uncertainty and risk of Covid-19, the Bank has also considered a worst-case scenario whereby the pandemic has spread extensively in the country and lockdowns are implemented. Should such a situation occur, overall growth for 2020 could fall by as much as -10.3% and if it extends into 2021, real GDP for that year would fall by a further -5%. It is therefore imperative that the country maintain its status as Covid19-free.

4.2. Fiscal

TThe near-term fiscal outlook for the fiscal sector remains grim and the medium term highly uncertain. Loss in revenue both from log exports and domestic sources amid mounting spending pressures are expected to widen the fiscal deficit to as much as -4% of GDP in 2020. The tail end risks of the pandemic lingering on into 2021 is high, which could lead to a sizeable revenue gap and further erode the government's fiscal position.

Moreover, across the medium term, fiscal sustainability is a crucial issue. Spending pressures will come from multiple fronts and donor support remain crucial to ease the budgetary implications. With the heighted demand and need with regards to the present stimulus package, government might be compelled to put together an additional stimulus package in 2021. Additionally, population growth will also mean greater demand for social services and strain existing infrastructures. Aside from donor assistance, these issues would mean higher demand for debt financing and the need for broader sources of tax and macroeconomic growth. Importantly, the effective and efficient use of public finances can contribute to ensuring fiscal sustainability over the horizon.

Due to the importance of fiscal policy as the key policy lever for the country to confront Covid-19 and other once in a generation shocks, the following measures could be considered in the long term. Firstly, post-Covid, the country's resilience buffers (such as fiscal cash buffers) should be enhanced and a rainy-day fund or sovereign wealth fund set up. This fund could be financed through the allocation of certain proceeds from the extractive industry and could provide a stabilizer for future shocks or for future fiscal financing gaps. Secondly, the government's debt management strategy could consider having a certain debt ratio for disaster policy responses above the current debt thresholds. This would enable government to proactively respond to shocks and also avoid delaying other important development projects.

4.3. External

The outlook for the external sector in 2020 is principally favourable. This is due to the considerable donor support for the country's Covid-19 response and weaker investment and consumption demand that translates to less overseas payments for goods and services. As such, the current account deficit is projected to narrow with the financing sufficiently

[6] CBSI Revised Impact of Covid-19 on the Solomon Islands Economy, http://www.cbsi.com.sb/immediate-release-impact-of-covid-19-on-the-solomon-islands-economy-revised/

coming from the well-stocked level of foreign reserves. However, over the medium term, the roll out of the key pipeline infrastructure projects means a widening of the current account deficit with high capital imports, although this will be financed invariably by the capital and financial accounts.

4.4. Monetary

Despite the weak monetary conditions in the first half of 2020, the forecast for the key monetary aggregates is expected to pick up by the end of 2020 and beyond, aligned with the medium-term economic growth forecasts. Reserve money and broad money are forecasted to grow moderately. Growth in private sector credit is anticipated to fall by end 2020 and pick up but at a moderate pace over the medium term. Nonetheless, excess liquidity is expected to continue trending upwards. Downside risks to this outlook include any unfavourable developments in the external sector related to Covid-19 that could further dampen conditions.

4.5. Inflation

Despite the volatility of betel nut on headline inflation in the first part of the year, food, transport and energy prices are expected to ease into the second half of the year. The end period 2020 headline inflation is projected at around 4.2%.

The outlook for 2021 is for headline inflation to rise as consumer demand picks up and imported inflationary pressures build up, although end period 2021 inflation should ease and hover around 3%.

Upside risks to this inflation outlook include a prolonged extension of Covid-19 into most of 2021 that could further dampen consumer demand and core inflation. Downside risks on the other hand, include supply-side shocks from weather and earlier than expected rise in oil prices that could increase inflationary pressures.

6. MONETARY POLICY STANCE

Given the Covid-19 situation and the expected fall in real GDP in 2020, as well as the prevailing downside risks, CBSI has resolved to maintain the expansionary monetary stance. This will further provide much needed support to the domestic economy. Moreover, inflation is expected to ease in the second half of the year despite the betel-nut driven volatility in early 2020. However, should the situation change, the Bank shall take appropriate actions accordingly.