CENTRAL BANK OF SOLOMON ISLANDS

Monetary Policy Statement

March 2014

Central Bank of Solomon Islands
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Table of Contents

List of Figures and Tables

1. Overview of 2013

The global economy in 2013 outperformed previous expectations as economic activity and world trade strengthened during the second half of the year. The previous growth estimate of 2.9% in the International Monetary Fund's (IMF) October 2013 World Economic Outlook was surpassed to reach an estimated 3.1% in its latest January 2014 edition.

Driving the slightly better growth outcomes for 2013 were larger than expected inventory demands in the advanced economies as well as resurgence in China's economic activity during the final six months of the year as a result of improved investment conditions. These improved prospects also aided the overall growth performance in the emerging market and developing economies, together with stronger growth performance witnessed by India. Given these changes, latest 2013 growth estimates from the IMF increased from 1.2% to 1.3% in the advanced economies while estimates for the emerging market and developing economies also rose from 4.5% to 4.7% (see Table 5.1).

In broad terms, global inflation eased further in 2013 on the back of a lower inflation rate in the advanced economies to 1.4% from 2%, and a levelling off in the inflation rate of emerging market and developed economies at 6.1%. Part of this softening reflected the sustained weakening in food and energy prices. More specific to the Solomon Islands, Tapis oil prices fell, on average, by 5% in 2013 whilst international rice prices[1] significantly fell by 10% on 2012 levels.

The domestic economy also showed signs of improvement throughout the second half of the year as revised real GDP growth estimates stood at 3.2% for 2013, slightly above the September MPS forecast of 3.1%. This was a result of slightly better than expected log production in the final quarter of the year helped by improved conditions in fishing, manufacturing, and agriculture, despite a weaker than anticipated performance in mining. However, economic growth continued to slow compared to revised 2012 figures of 3.3% and 10.6% in 2011. Growth in 2013 was supported by increases in the fisheries, manufacturing, utilities, transport and communication sectors as well as slower yet positive growth in construction, retail and wholesale and finance sectors. Forestry and agriculture, although witnessing further contractions, witnessed slower declines than 2012. On the other hand, mining, the country's second biggest export, exhibited a fast decline than the previous year.

Key monetary indicators also improved throughout the second half of 2013, reflecting growth in foreign inflows, a surge in private sector credit, and better performance in the real economy. Given these developments, reserve money and broad money increased by 13% and 9%, respectively, over the last six months to December 2013. Following suit, excess liquidity observed a slight increase of 1% over the same period despite the progressive build-up in the float and issue of central bank-backed Bokolo bills.

The balance of payments remained positive over the second half of 2013 as gross foreign reserves climbed higher to reach $3,909 million as of the year-end. The favourable outcome reflected a rebound in net flows from donor cash inflows, trade receipts, and fishing licences, particularly in the fourth quarter. Revaluation gains over the second half year also attributed to the positive outturn.

Despite the overall gains, the current and capital accounts continued to deteriorate across the second half of 2013. The current account posted another deficit of $322 million, echoing high deficits in trade in services and primary income accounts as well as a surplus reduction in the secondary income account, despite the notable narrowing in trade in goods account. Meanwhile, the fall in donor capital inflows for government development projects during the period resulted in a net surplus of $263 million in the capital account for the last six

[1] Based on Thai 5% prices.

months of the year, a significant decline compared to the $341 million surplus in the first six months.

The Government posted a fiscal deficit of $9 million during the second half of 2013 compared to the revised fiscal surplus of $143 million during the first six months. The fiscal deficit during the last six months was due to a larger rise in expenditure than the increase in revenue collection. Revenue including grants rose by 25% to $1,776 million against the first six months although 1% below budget estimates. Meanwhile, total expenditure jumped by 41% against the preceding period despite remaining 18% under budget. On the other hand, public debt stock dropped from $968 million to $949 million over the same period, equivalent to 15% of nominal GDP.

Headline inflation, as measured by the three months moving average, reached 6.5% in August 2013 before steadily declining in the months following before falling to 3.0% in December 2013, a rate not witnessed since February 2011. The lower inflation rate was attributed to slower increases in food, housing and utilities, and transport and communication indices. By component imported inflation fell from 1.4% in June 2013 to a contraction of 0.9% by December 2013, reflecting falling domestic prices that in turn, imitated the downward trends in the international prices of Solomon Islands' major imports. During the period, December 2013 Thai rice and US wheat prices fell by 14% and 7%, respectively on June 2013 prices with some fluctuations between months, while average Tapis oil prices for the period fell by 3%.

Similar movements were also exhibited in domestic inflation, which also declined from 7.8% to 5.7% over the same period. Given this, the average headline inflation rate of 5.3% remained within the Central Bank's forecasted range of 5%-7%, as projected in the September 2013 MPS statement.

2. International Economic Developments

2.1 Global Economic Growth

Since the September 2013 Monetary Policy Statement (MPS), global economic conditions, albeit remaining weak, recovered moderately in the second half of 2013, registering an annualised growth of 3.3% in the December quarter. Much of the initial acceleration came from improvement in the advanced economies. The stronger external demand and growth momentum in the advanced economies also benefited the emerging market and developing economies and the Asia-Pacific region. With this turnaround, the global economy is estimated at 3.0% growth in 2013, slightly lower than the 3.1% growth registered in 2012[2].

In the advanced economies, growth registered a 2.0% year-on-year in the December quarter, and an annualised growth of 1.3%. Growth is stronger in the United States (US), with the economy expanding at an annualised 3.2% in the fourth quarter, following a revised 4.1% growth in the third quarter. The recovery continues to be driven by strong private consumption, investment and exports. On yearly basis, annual growth registered a 1.9%, dragged down by weaknesses in the first half of the year. In Japan, the economy grew more gradually to 1.7% in 2013, up from 1.4% in 2012, but grew more strongly at 3.1% in the December quarter. The recovery was aided by strong export growth, consumption and business investment[3].

Growth in the euro area has now been positive for two consecutive quarters to 0.5% in the December quarter, although the economy contracted by 0.4% over 2013. The gradual recovery is supported by growth in consumption, investment, imports as well as improved industrial production and competitiveness. In the United Kingdom,

[2] Source: IMF World Economic Outlook, January 21 2014.

[3] Source: http://www.theguardian.com – accessed on February 2014

economic growth also picked up in 2013, with the economy expanding at 2.3% in the December quarter. Growth in the euro area is expected to improve to 1.0% in 2014 from 0.4% contraction in 2013.

In the emerging market and developing economies, growth moderated at 4.8% in the December quarter with an annualised growth of 4.7% in 2013. Growth was largely driven by the developing Asian economies with China, one of the Solomon Islands major trading partners taking the lead. Annual GDP in China has been relatively steady over 2013, with growth of 7.8% in the December quarter and 7.7% over 2013. Strong household consumption, investment and export growth attributed to the higher growth.

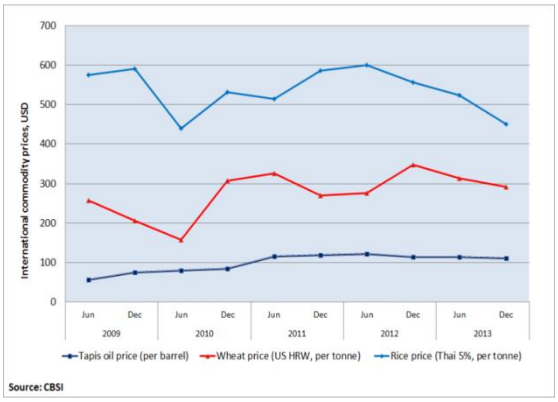
Growth in the East Asia and the Pacific region moderated to 7.2% in 2013 from 7.4% in 2012 reflecting a moderation of economic activity in the region. Solomon Islands other major trading partners, including Australia and New Zealand also indicated modest growth during the period. In Australia, economic activity cools down slightly on weaker domestic demand, with GDP expanding by 2.3% in the third quarter, down from 2.5% in the second quarter. Given this, GDP growth is expected to reach 2.5% for 2013. In New Zealand, the economy grew by 1.4% over the previous quarter with faster growth in manufacturing and agriculture driving the acceleration. Improvement in private consumption, fixed investment, restocking of inventories and net external contributions also attributed to the positive upturn. In 2013, the Reserve Bank of New Zealand (RBNZ) expected the economy to grow by 2.8%, up from the previous estimate of 2.5%[4].

2.2 International commodity prices and global inflation

International commodity prices as measured by the World Commodity Price Index (WCPI), declined by 1.4% to 180 on average in 2013. Drivers of the deceleration came from the declines in both fuel and non-fuel prices, falling by 1.7% and 1.2% on average, respectively. International food prices, one of the key components of the international commodity prices as indicated by the Food and Agriculture Organisation's (FAO) price index declined further by 1.6% to 209.8 in 2013.

More specifically, prices of major imported food types for Solomon Islands, namely rice and wheat, have also demonstrated falls in the rice and wheat prices. Rice prices[5] have fallen since the second quarter of 2013 to reach US$443 per ton in the fourth quarter. Similarly, wheat prices[6] have fallen since the first quarter of 2013 but regained slightly in the fourth quarter to US$308 per ton. On an annual basis, average rice prices fell to US$506 per ton from US$563 per ton in 2012 and wheat prices down to US$312 per ton from US$313 in 2012. Meanwhile, between June 2013 and December 2013, the average prices of rice and wheat fell from US$524 and US$313 per ton to US$451 and US$292 per ton, respectively (see Figure 2.2.1).

Figure 2.2.1: International prices of major imports of the Solomon Islands



International oil prices, indicated by the World Bank's average crude oil price fell by 3% to US$105 per barrel from the previous quarter and down by 1% to US$104 per barrel in 2013. Consistent with the global oil price,

[4] http://www.focus-economics.com/en/economy/region-outlook/Asia – accessed on February 2014

[5] Thai 5% rice prices

[6] US Hard Red Winter (HRW) wheat prices

Tapis oil the main imported fuel for Solomon Islands also fell by 5% to US$113 per barrel on average in 2013, continuing the 1% drop in 2012. More recently, average Tapis oil prices fell from $114 per barrel in the first six months of the year to $111 per barrel during the final six months of 2013 (see Figure 2.2.1).

Inflationary pressures for Solomon Islands main trading partners remained contained. In China, year-average inflation for 2013 is at 2.6%, well below the authorities' target of 3.5%. This was mainly due to non-food price inflation which remained subdued and food price inflation that remained unchanged during the year. In Australia, year-on-year saw inflation falling to average 2.2% in the September quarter of 2013. However, against the second quarter, inflation increased slightly by 1.2% with housing and transport prices driving the accelerations. In 2013, annual averaged inflation remained low at 2.2%. Similarly average inflation for New Zealand remained low at 1.6%, although slightly above the 1.0% observed in 2012. However, this level is still within the Reserve Bank of New Zealand's 1.0%-3.0% target range.

3. Domestic Economic Developments

3.1 Monetary Conditions

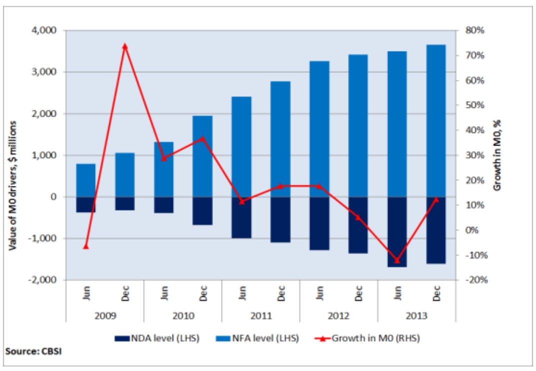
Reserve money and monetary aggregates exhibited a recovery during the second half of 2013, which in turn, reflected a drawdown in government deposits and growth in foreign inflows. Furthermore, private sector credit expanded further albeit slower than atypical upsurge witnessed in the first six months of the year. Meanwhile, excess liquidity saw a slight increase of 1% between June 2013 and December 2013 by the growth in net foreign assets and fall in claims of central government deposits. This was despite the rise in the float and issue of Central Bank-backed Bokolo bills over the period.

<u>Reserve Money and Broad Money</u>

Reserve money (M0) bounced back in the second half of the year registering a 13% over the second six months of 2013 to reach $2,034 million as at December 2013. This was on the back of a 12% contraction in the first six months of the year. The surge in M0 was attributed to the narrowing of net domestic assets (NDA) of CBSI from $1,684 million in June 2013 to $1,613 million in December 2013 (see Figure 3.1.1). The narrowing was mostly explained by an 8% drawdown in central government deposits. The rise in M0 was also driven by the accumulation of NFA of CBSI, which grew by 5% over the second half of 2013 to reach $3,651 million. The faster expansion in NFA was largely caused by increases in foreign inflows, mainly donor cash inflows, trade receipts, and fishing licences, over the same period.

This growth was also reflected in the components of reserve money. Currency in circulation grew by 12% between June 2013 and December 2013 to reach $603 million while ODCs deposits held with CBSI increased by 13% at $1,423 million by year end. Over the same period, OFCs' transferable deposits held with CBSI declined by 7% from $8 million to $7 million over the same period. Despite the rally during the second half of the year, M0 was 1% lower than a year ago.

Figure 3.1.1: Growth and Sources of Reserve Money

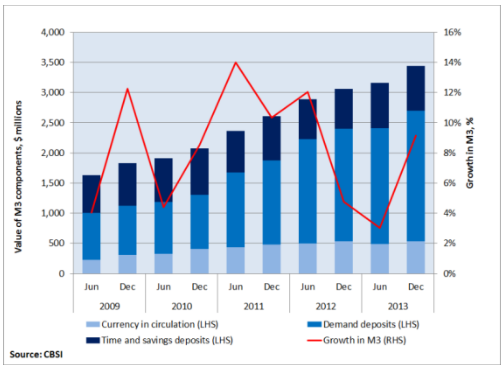


Broad money supply (M3), which measures the total supply of money in the economy, followed a similar path to that of reserve money and other monetary aggregates. The growth in M3 quickened in pace to 9% reaching $3,445 million as of December 2013.

This was a marked increase from the 3% growth rate exhibited in the first half of 2013 (see Figure 3.1.2). The rise in broad money can be explained by both a narrowing in the NDA of the banking system and a rise in the NFA of the banking system. NDA of the banking system narrowed to negative $326 million as credit to private sector grew by 5% and a 6% drawdown in the deposits held by central government. In addition, the increase in broad money was also driven by a 4% in the NFA of the banking system reaching $3,784 million on the back of the rise in foreign inflows.

The growth in M3 was also reflected in its components; currency in circulation rebounded by 8% to $531 million as of December 2013 compared to June 2013, while the increase in demand deposits jumped by 13% to reach $2,167 million. Making up the final component of M3, time and savings deposits witnessed no growth at $746 million over the same period, significantly slower than the 11% growth demonstrated in the second half of 2012. Meanwhile, year-on-year growth exhibited 12% growth as of December 2013.

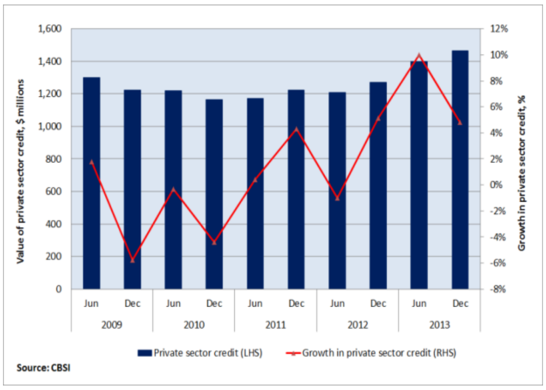
Figure 3.1.2: Components and Growth in Broad Money



Credit conditions

The state of net domestic credit (NDC) improved from $12 million in June 2013 to $162 million in December 2013. This was a direct outcome of growth in private sector credit and capital accounts, which bolstered the fall in credit to non-financial public sector (NFPS). At the end of the first half of 2013, net credit to NFPS narrowed from minus $1,386 million in June 2013 to minus $1,302 million by December 2013 as a result of a fall in government deposits claims. The other major component of NDC, private sector credit (PSC), expanded at a slower pace of 5% to reach $1,465 million in December 2013[7] from $1,398 million as of June 2013 (see Figure 3.1.3).

Figure 3.1.3: Private Sector Credit Growth



The 5% growth in credit from ODCs was driven by the increase in loans, which grew by 11% from $1,222 million in June 2013 to reach $1,290 million by December 2013. On the other hand, the growth in loans was somewhat dampened by falls in all other main forms of lending namely overdrafts (falling 3%), lease financing (falling 25%) and trade bills (falling 83%). Following these developments, the composition of credit over the review period became more concentrated in loans up from 88% to 90%, while overdrafts fell slightly from 10% to 9%, and lease finance and trade finance accounting for the remainder.

Compared to June 2013, the sectoral profile of private sector credit from ODCs remained the same for the largest recipients; the personal, distribution, construction and communications sectors continued to dominate, accounting for 70% of total credit from ODCs in December 2013 (see Table 3.1). Other developments included a 40% increase

[7] PSC refers to the total credit to private sector from ODCs and CBSI.

in credit to the tourism sector from $73 million to $103 million over the same period.

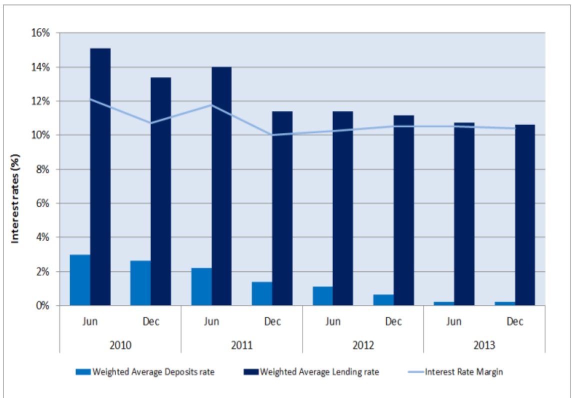
Table 3.1: Credit from ODCs by sector

	Jun 2012 $ Millions	Dec 2012 $ Millions	Jun 2013 $ Millions	Dec 2013 $ Millions	Change over Dec 2012 and Jun 2013 $ millions	Change over Jun 2013 and Dec 2013 $ millions
Personal	332	375	416	472	41	56
Distribution	181	166	200	212	34	12
Construction	174	190	192	182	2	-10
Communications	90	107	159	140	51	-19
Tourism	73	80	74	103	-6	30
Professional and Other Services	68	69	68	67	-1	-1
Transport	64	63	68	72	5	4
Manufacturing	58	57	56	54	-2	-1
Statutory Corporations	0	36	38	32	2	-6
Agriculture	20	27	33	42	6	9
Forestry	47	48	26	40	-22	14
Bills Receivable	25	7	22	4	15	-18
Fisheries	2	4	19	3	16	-16
Entertainment and Catering	17	16	16	12	0	-4
Non-Resident	0	0	0	0	0	0
Mining and Quarrying	6	5	0	0	-5	0
Private Financial Institutions	0	0	0	5	0	5
Provincial Assemblies and Local Governments	0	0	0	0	0	0
Central Government	0	0	0	0	0	0
Souce: CBSI						

Interest rates

Based on preliminary data, the weighted average lending rate edged downwards from 10.73% in June 2013 to 10.62% in December 2013 with some variation across the months and sectors (see Figure 3.1.4). The increase over the period was ascribed to a significant reduction in lending rates to private financial institutions as well as lower rates offered to the forestry sector. On the other hand, interest rates to the mining sector increased slightly.

Figure 3.1.4: Weighted Average Deposit and Lending rates



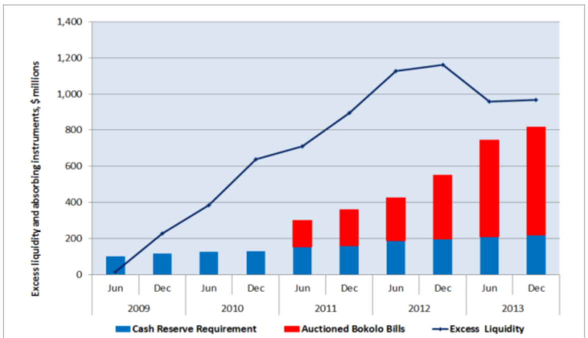
Source: CBSI

Meanwhile, the weighted average deposit rate edged upwards to 0.21% in December 2013 from 0.20% in June 2013. The slight rise mainly reflected by increases in demand deposit and time deposit rates with the exception of time deposits of 3-6 months maturity, which more than offset the decline in savings deposits. Overall, the interest rate margin narrowed from 10.53% in June 2013 to 10.41% at the end of December 2013.

Liquidity

Total liquidity in the banking system grew at a slower rate of 2% to $1,280 million at the end of December 2013, compared to a 13% contraction recorded in the first six months. Meanwhile, growth in excess liquidity[8] also witnessed a subdued increase of 1% to register a level of $969 million following a 16% decline in the previous half of 2013 (see Figure 3.1.6). With the cash reserve requirement maintained at 7.5% of total deposit liabilities, growth observed over the period was powered by growth in NFA and a drawdown in government deposits, which offset the increase in the issued stock of auctioned Bokolo bills. With the increased availability of stock floated on the market, the total absorbed by commercial banks as of December 2013 reached $600 million, up from $535 million six months prior. The rise in stock invested in Bokolo bills witnessed a hand-in-hand with an increase in the weighted average yield (WAY) from 0.51% in June 2013 to 0.58% in December 2013.

Figure 3.1.5: Excess Liquidity and Liquidity Absorbing Instruments



Source: CBSI

[8] Following improvements in measurement, CBSI is now monitoring excess liquidity as opposed to free liquidity.

CBSI continued to facilitate the auctioning of government treasury bills on behalf of the Government throughout the year. However, the cap on treasury bills remained unchanged at $40 million despite the robust demand. Over the review period, treasury bill rates reversed their previous upticks; WAYs for 91 days and 182 days treasury bills fell from 0.46% and 1.47% in June 2013 to 0.24% and 1.03% in December 2013, respectively. Meanwhile, the 56 days bill rate, which stood at 0.47% in June 2013 dropped to 0.27% in November 2013. However, the Government did not auction 56 days treasury bills during the month of December 2013.

3.2 External Conditions

The balance of payment (BOP) external position remained positive over the second half of 2013 with gross foreign reserves advancing to $3,909 million. The favourable position was driven by a rebound in net flows from donor cash inflows, trade receipts, and fishing licences, particularly in the fourth quarter. Revaluation gains over the second half year also attributed to the positive outturn. Despite the overall gains, the current and capital account, key components of the BOP account continued to deteriorate across the second half of 2013.

Current and Capital Account Balances

The second half of 2013 saw the current account witnessing another deficit of $322 million, following a $346 million deficit in the preceding half year. The deterioration largely came from high deficits in trade in services and primary income accounts with net outflows of $247 million and $306 million, respectively. The reduction in the secondary income surplus from $513 million to $237 million in the second half year also attributed to the large current account deficit. The deceleration was mainly due to significant fall in donor inflows in the third quarter which outweighed the higher donor inflows in the fourth quarter. In contrast, the trade in goods account deficit narrowed significantly from $162 million in the first half to $7 million in the second half of the year. Meanwhile, the capital account recorded a surplus of $263 million in the second half; however, this was a 23% deceleration from a $341 million surplus in the first six months. The decline was mainly due to fall in donor capital inflows for development projects. As a result, the current and capital accounts recorded a net borrowing (deficit) of $59 million in the second half, compared to the net $5 million borrowing in the first half of 2013.

In trade in goods account, the improvement in the second half of 2013 came from higher growth in export receipts relative to a lesser increase in import payments. Export receipts increased by 13% to $1,706 million in the second half, a turnaround from the 17% drop to $1,505 million in the first six months of 2013. Drivers of the uptick came from higher earnings in log, fish, cocoa, copra and palm oil exports during the second half year.

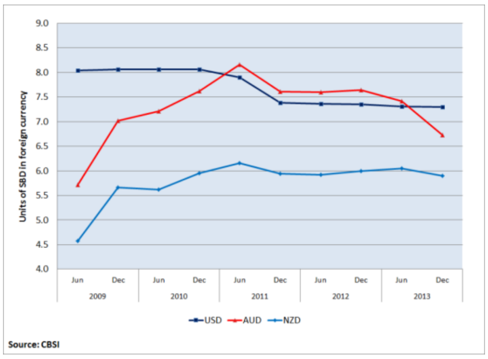
Log exports increased by 13% to $822 million, from a 14% fall in the previous half year on higher volumes, fish exports rose considerably by 95% to $299 million, cocoa up by 32% to $39 million, copra up by 6% to $34 million and palm oil exports went up by 15% to $120 million. Both higher export volumes and improved prices explained the increase in copra, cocoa and fish exports while improved prices boosted palm oil export earnings. Conversely, export earnings from minerals, timber, and other exports and to a lesser extent re-exports fell across the second six months of the year. Export earnings from mineral fell by 8% to $298 million, extending the decline witnessed since the second half of 2012. Timber exports fell by 15% to $38 million, other exports down by 59% to $21 million and re-export slid by 36% to $15 million.

On imports, the smaller rise by 3% to $1,713 million (f.o.b) in the second six months of the year was mainly on account from food and live animal payments which increased by 14% to $386 million, beverages and tobacco, up by 34% to $32 million, animal and vegetable oil payments rising by 17% to $10 million and basic manufactures which went up by 15% to $279 million. Increase in miscellaneous imports by 9% to $113 million, and unspecified imported goods rising to $5 million, from zero records in the first half year also explained the increase in imports. Conversely, in the second half year fuel imports fell by 6% to $437 million on falling global oil prices, crude materials down by 7% to $23 million and chemical imports down by 17% to $126 million.

Exchange Rates

The Solomon Islands real effective exchange rate (REER) appreciated by 3% in the second six months of 2013, following a 5% appreciation in the preceding half year. Drivers were the appreciation of the Solomon Islands nominal effective exchange rate (NEER) by 4% and relatively higher inflation rate in Solomon Islands compared to the trading partners. In particular, the appreciation was largely due to the strengthening of the SBD against the nominal bilateral exchange rates of both US$ and AUD, the two main trade invoicing currencies. This means, the elevated real effective exchange rate indicated a loss in SI international competitiveness, relative to its major trading partners. However, on a positive note, it may also mean that imports become relatively less expensive which helps dampen imported inflationary pressures.

Figure 3.2.1: Nominal Bilateral Exchange Rates

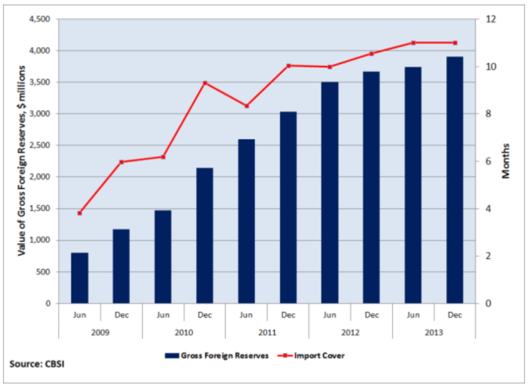


In terms of the nominal bilateral exchange rate, the SBD on average appreciated against other major trading currencies with the exception of the Pound Sterling and the Euro, which depreciated across the second six months of 2013. The SBD appreciated by 0.14% against the US$ to $7.30 per US$. Against the Australian dollar, the SBD also appreciated by 9% to $6.73 per AUD, against the Japanese yen by 5% to $7.33 per 100JPY and by 2% against the New Zealand dollar to $5.90 per NZD (see Figure 3.2.1).

Reserves

The gross foreign reserves (GFR) accumulated further during the second six months to $3,909 million at end December 2013 from $3,742 million at end June (see Figure 3.2.2). The build-up resulted from net inflow of $121 million associated with the increase in cash donor inflows, trade receipts and fishing licenses, particularly in the fourth quarter of 2013. Revaluation gains of $44 million during the second half year, also aided growth in reserves. This level is sufficient to cover 11.0 months of import of goods and services.

Figure 3.2.2: Gross Foreign Reserves and Import Cover



3.3 Domestic Conditions

The Solomon Islands economy expanded at a below trend pace over the year 2013, although recent indicators point to some improvement in the second half year, particularly toward the end of the year. After growing very strongly over recent years, mining investment appears to have fallen by around 13% from 64% growth recorded in 2012. At the same time, growth in agriculture and forestry activities contracted by 3.5% and 1.7%, respectively. Nevertheless, growth was supported by increases in the fisheries,

construction, manufacturing and transport and communication sectors.

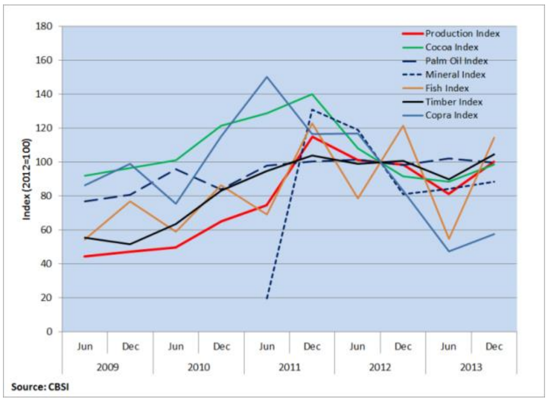
Economic Growth

Real GDP growth moderated to 3.2% in 2013 from revised growth estimates of 3.3% in 2012. The slower growth was mainly driven by subdued performance across key export sectors whose growth were impeded by unfavourable commodity prices and adverse weather conditions, particularly in the first half of the year. Growth in the mining sector has fallen across the year amidst improved productivity in the second half year, dragged down by weaknesses in the first half year. In the agriculture sector, growth was pinned down by contraction in copra and cocoa production in the first half year, despite improvement in the second half year. Similarly, the contraction in the forestry sector was due to weak log output in the first half year which offset the 16% rise in the second half year. On a positive note, real GDP growth was aided by favourable performances in fisheries rising by 27%, manufacturing up by 20%, construction by 11% and transport and communication which went up by 9%.

Production

Domestic production activities improved markedly in the second six months of 2013, following the recovery in the country's major trading partners as well as pick up in global commodity prices, particularly in the fourth quarter. The CBSI production index, a composite measure of the six main exported commodities, rebounded in the second half year of 2013 to 100 points, after falling since the second half of 2012. The upturn largely reflected improved production (on average) in fish, rising by more than two fold to 16,826 tons, log output went up by 16% to 1,020,324 cubic meters, copra up by 21% to 7,634 tons, coconut oil by 66% to 35 tons, cocoa 12% to 2,384 tons and gold up by 5% to 30,067 ounces (oz). In contrast, all palm products declined in the second half year mainly on weak international prices. On annual basis, the production index fell to 91 points in 2013 from 100 points in 2012. The downturn largely reflected falls across all commodities, dragged down by weaker performance, softer commodity prices, and adverse weather conditions in the first half year.

Figure 3.3.1: CBSI Production Index and Commodity Indices



Employment

Labour market conditions mildly weakened in the second six months of 2013. Partial employment indicators from the Solomon Islands National Provident Fund (SINPF) showed active and slow active contributors moderated to an average of 48,034 members over the final quarter of 2013, after growing strongly in the second and third quarters of the year. The slight fall reflected the slowdown in the domestic economy as well as those leaving the labour force. In 2013, about 2,800 members withdrew from the SINPF of which the majority of withdrawals were attributed to old and retiring members as well as some partial withdrawals from redundancy claims. This result compared to the 2,300 new members reflecting the slow employment creation during the year[9]. Partial employment indicators from the CBSI Job advertisement survey also showed similar movement falling by 25% across the second half year. The education sector, international organisations and private businesses recorded the biggest fall during the period.

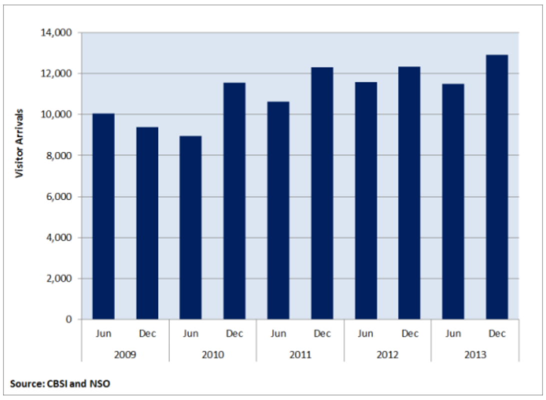
Tourism

[9] Source; CBSI 2014 Annual Consultations.

The tourism industry, as measured by visitor arrivals rebounded in the second half year, after contracting in the first six months. Total visitor arrivals rose by 12% to 12,918, driven by high visitor arrivals in the third quarter, which accounted for 53% of the total arrivals during the second half period. Other indicators including loans to the tourism sector also indicated increases of 40% during the period.

In terms of visitors' origins, Australian tourists continued to account for the bulk with 45% of total visitors. This followed by other Asian countries, New Zealand and Papua New Guinea. The completion of the Munda and Gizo International Airports including other vital infrastructures such as wharves and bridges around the country in 2013 might boost the progress in this industry.

Figure 3.3.2: Visitors Arrivals

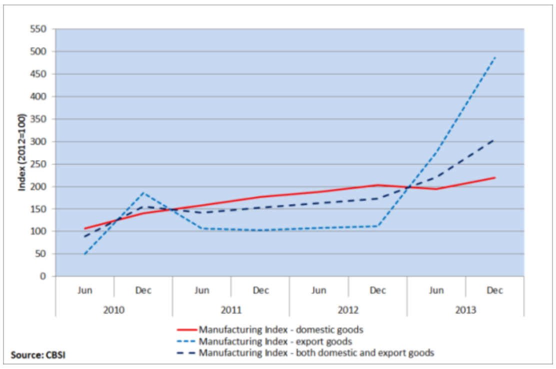


Manufacturing

The manufacturing industry, measured by the CBSI manufacturing index continues to improve, rising by 12% to 219 points across the second half year (see Figure 3.3.2). Growth was mainly driven by manufactured products destined for both exports and domestic. This is reflected in the domestic and export component of the index, which increased by 38% to 305 points. Manufactured products that registered increases in the second half year include alcohol, soft drink, biscuits and fish production both for exports and domestic consumption.

Other indicators including manufactured goods imports also improved reflecting the increase in manufacturing activities during the period.

Figure 3.3.3: CBSI Manufacturing Index, domestic and export goods



Electricity

Following growth in the first half of the year, energy demand also rose over the second half of 2013, consistent with growth in the domestic economy. The level of electricity generated during the period increased by 6% to 41,668 megawatt hours (MwH). Of this generated volume, units of electricity sold accounted for 74% (30,651 MwH) with the commercial industries accounting for the bulk. Units of electricity sold to commercial industries increased slightly by 3% to 19,097 MwH. Conversely, electricity for domestic consumers fell by 13% to 6,604 MwH in the second half of the year.

Retail and wholesale

Retail and wholesale activities experienced sustained growth to improve in the second six months of 2013 as indicated by partial indicators for this sector. Credit issued by commercial banks to distribution sector increased by 6% to $212 million, although slower than the 21% growth registered in the first quarter. Drivers mainly came from loans issued specifically for retailers and wholesalers category which rose by 8% to $120 million over the second half year.

Foreign Direct Investment

Investment conditions in the country remained buoyant in the second half of 2013, as business confidence improved. During the second six months, the Foreign Investment Division (FID) approved 101 foreign investments applications. This is a 40% increase from the preceding half year with an estimated value of $521 million. The run-up in foreign investment in the second six months of 2013 reflected strong investment growth in forestry, mining, fisheries, manufacturing, tourism, construction sectors and other services. Another partial indicator FDI inflows recorded in the Balance of Payments also indicated similar movements. Investment income from FDI increased to $398 million from $392 million in the first half of 2013, on the back of higher investment income from dividends, equity and investment fund shares.

Construction

Construction activities remained significantly strong in the second six months of 2013, following the increase in both Government and private sector construction activities during the period. Building permits issued by Honiara City Council, and used by CBSI to measure construction activities in Honiara grew significantly by 91% to 84 permits during the second half year. Of the total permits issued, residential permits accounted for 56%, followed by commercial with 24% and other permits accounting for the remaining 20%. On annual basis, residential permits increased to 128 in 2013 from 113 permits in 2012 signalling the improved construction activities. Another indicator, personal loans on housing, issued by commercial banks also showed improvement, rising by 13% to $412 million. This is expected as residential building activity pick up in the recent years. Imports of merchandise goods also improved over the year.

3.4 Fiscal conditions

Over the second half of 2013, the Government recorded an overall fiscal deficit of $9 million and a corresponding recurrent surplus of $466 million. This compares to a revised fiscal surplus of $143 million and a recurrent surplus of $350 million over the first half of the 2013. The small fiscal deficit reflected larger government and donor spending, which offset the improved revenue collection and grant allocations during the last six months of the year. Meanwhile, public debt stock at the end of December 2013 fell to $949 million, equivalent to 15% of nominal GDP[10].

Revenue

Total revenue including grants witnessed a 25% increase from a revised $1,417 million in the first of half of 2013 to $1,776 million during the second half of the year a magnitude. Despite this, total revenue was 1% below budget estimates for the period of $1,797 million. The below budget outcome was a result of lower than expected recurrent revenue and recurrent grants offsetting the larger than expected development grants received during the second half of the year.

Recurrent revenue, comprised of local revenue and recurrent grants, picked up in the second half of the year by 18% at $1,659 million, explaining much of the growth in total revenue compared to the first six months of 2013. On the contra, recurrent revenue underperformed by 2% against the budget forecast of $1,691 million.

Local revenue surged by 28% from $1,212 million in the first six months of 2013 to $1,547 million in the final six months of 2013. Furthermore, local revenue collection exceeded budget expectations of $1,353 million by 14% attributed to strong performances across all three major categories of revenue collection, and particularly in Inland Revenue collections and non-tax revenues.

Inland Revenue Division (IRD) collections in the second half of 2013 grew by 17% compared to the first half of 2013. IRD revenue stood at $915 million, 12% above budget forecasts of $817 million. Against the previous six months, robust performance was bolstered by strong gains among all IRD

[10] Based on 2013 nominal GDP.

categories. Meanwhile, against the budget, only sales tax underperformed. Company tax increased by 44% against the previous six months, and 27% against budget forecasts, amounting to $170 million over the last six months of 2013. Similarly, private sector PAYE collections jumped by 30% compared to the first six months, and 4% against the budget to reach $181 million. At $354 million, goods tax also posted healthy gains over the review period, up 7% on the first six months to June 2013, and 5% above budget expectations. Other notable performances were witnessed in withholding tax, which increased by 9% on the first half of the year, and 45% higher than the budget to reach $123 million during the final six months of the year. Public sector PAYE collections, which stood at $47 million, witnessed modest gains compared to the previous six months and against the budget, by 5% and 7%, respectively. Meanwhile, stamp duty and licensing observed little change over the review period while sales tax collections rose by 16% at $30 million for the final six months of 2013, despite underperforming by $4 million against budgeted estimates.

Collections registered by the Customs and Excise Division (CED) totalling $414 million, also increased by 8% over the review period as well as exceeding the budgeted forecast by 3% to $382 million. The higher than expected growth in customs revenue level reflected gains in log duties, which overcompensated weaker than budgeted performances in other CED categories. Log duty collections recorded a 6% growth on the first half of 2013 as well as beating budget estimates by 6% to reach $209 million for the last six months of 2013. On the other hand, import duty collections met budget expectations at $114 million, a slight fall compared to the previous six months of $115 million. Collections in excise duties at $79 million rose by 34% in the last six months to December 2013, despite slightly underperforming against the budget by 1%. Similarly, export duty collections, albeit $2 million below budget for the period, increased by $2 million compared to the first half of the year, reaching $10 million by December 2013.

Non-tax revenue collections also performed well over the last six months of 2013. Revenue collection improved significantly from $48 million during the first half of 2013 to record $218 million for the months July to December. Furthermore, this performance also exceeded budget forecasts of $133 million by more than three-fold. This outstanding performance was attributed to robust collections from the Ministry of Fisheries and Marine Resources.

Completing the recurrent revenue position was the weaker than expected results in recurrent grants. Compared to the previous six months of 2013, the value of recurrent grants had reduced by 44% from $197 million to $111 million in the last six months of 2013. Against the budget forecasts of $338 million, actual recurrent grants disbursed were 67% lower.

In terms of capital grants, however, disbursement had increased from $7 million during the first six months to June 2013, to record $117 million over the final six months of the year. Actual capital grants during the review period also exceeded the budget estimates of $106 million by 11%.

Expenditure

Total expenditure during the final six months of the year rose by 41% to reach $1,742 million compared to $1,235 million over the first six months of 2013. However, due to the containment of expenditure across the Government to ensure enough provisions were made available for the re-levelling exercise in teachers’ salaries during the first quarter to the third quarter of 2013, as well as unbudgeted expenses for Solomon Island National University scholarships, total expenditure was 18% lower than budget estimate of $2,132 million over the second half of 2013.

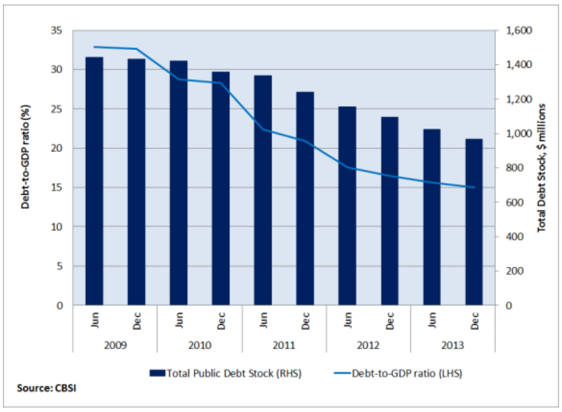
Recurrent expenditure spent in the second half of 2013, including budget support, rose by 13% to $1,193 million from $1,060 million expended in the first half of 2013. Meanwhile, against the budget, actual recurrent expenditure was 13% lower. The upturn on the first six months reflected growth in spending on payroll and goods services, whilst debt servicing fell slightly. As a result of the continued re-levelling exercise in teachers' salaries, payroll spending rose by 19% over the first half of 2013 to reach $423 million. This was also 3% above budget forecasts of $412 million. However, other spending areas, particularly in other goods and services, were executed with restraint as the Government pursued further containment of expenditure. Goods and services spending, despite increasing by 10% to $763 million over the review period, was well below (32%) budget estimates of $1,126 million. Meanwhile, debt servicing, fell slightly from $8 million to $7 million over the same period. Against the budget, actual expenditure on debt servicing was $1 million less than anticipated.

Similar to previous trends, development expenditure surged substantially from $175 million in the first six months of 2013 to $549 million over the last six months of 2013. However, actual development spending[11] over the period was 6% below budget expectations as budgeted donor funded development expenditure over the review period was not realised.

<u>Public Debt Stock</u>

Total public debt stock fell from $968 million in June 2013 to $949 million in December 2013 (see Figure 3.4.1). This was attributed to debt payments made to both domestic and external debt stock over the second half of the year. Domestic debt stock fell from $225 million in June 2013 to $205 million in December 2013. On the contra, external debt stock witnessed no net change over the same period as a direct result of the depreciation in the Solomon Dollar to the SDR and the Euro, which offset the external debt interest payments. Subsequently, external debt stock stood at $743 million as of December 2013. Subsequently, the debt-to-GDP ratio exhibited a marginal decline from 15.6% in June 2013 to 15% in December 2013.

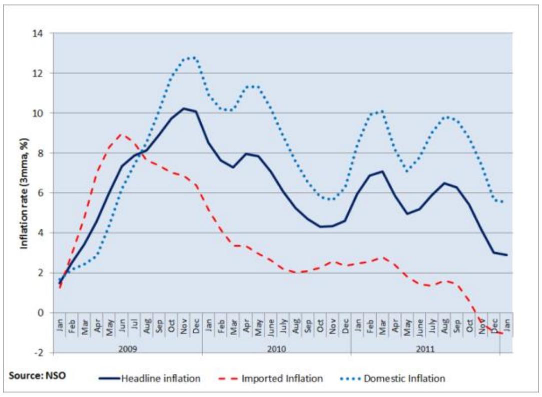
Figure 3.4.1: Total Public Debt Stock



3.5 Inflation

The headline inflation rate[12] stood at 3.0% for the month of December 2013, a marked decline from 5.2% registered in June 2013. Since the publication of the last MPS, headline inflation reached 6.5% in August 2013 before retreating in the following months to its December position (see Figure 3.5.1). With the latest data for January 2014 already available, the downward trajectory appears to be bottoming out although still declining somewhat to 2.9%.

Figure 3.5.1: Headline Inflation (3mma)



[11] SIG development expenditure also includes donor funds from the consolidated account but does not capture other development expenditure in the form of unappropriated funds.

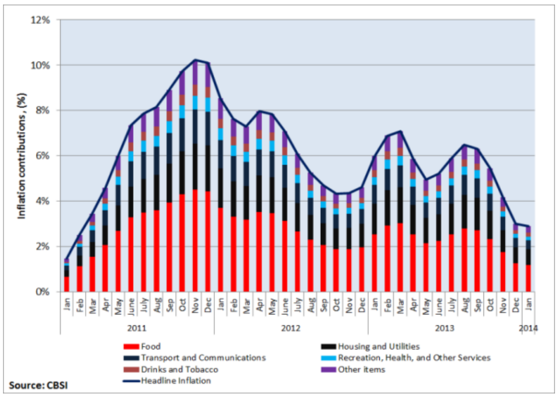
[12] Measured by a three months moving average (3mma)

The story behind the falling headline inflation can be ascribed to a significant slowdown in domestic inflation amidst falling imported prices, reflected by the negative imported inflation rate. The domestic inflation component, which reflects domestic price movements, fell from 7.8% in June 2013 to 5.7% in December 2013. Meanwhile, imported inflation, which represents imported price movements, fell from 1.4% to record minus 0.9% over the same period. As a result of these developments, the average headline inflation rate of 5.3% remained within the Central Bank's forecasted range of 5%-7% that was outlined in the September 2013 MPS statement.

Analysing the drivers that caused the downward trend in the Honiara Retail Price Index (HRPI), the slowdown from 5.2% in June to 3.0% in December was explained mainly by a retreat in food, housing and utilities, and to a lesser extent, transport and communications, although all categories observed deceleration in growth. Of the 2.2 percentage points fall, food accounted for 1 percentage point of that decline while housing and utilities explained 0.5 percentage points, and transport and communication contributed 0.3 percentage points to the fall in headline inflation.

By December 2013, of the 3% growth in the headline inflation, food accounted for the largest proportion at 1.3%, followed by housing utilities with 0.7%, transport and communications at 0.4%, recreation and health services as well as drinks and tobacco each contributing 0.2%. Clothing and footwear, household operations, and miscellaneous items explained the remaining 0.3% of the growth rate. This compared with the 5.2% headline inflation rate in June 2013, which was explained by food with 2.3%, followed by housing utilities with 1.2%, transport and communications with 0.7%, recreation and health services, and drinks and tobacco each contributing 0.3%, whilst clothing and footwear as well as household operations all contributed 0.2%. Miscellaneous items explained the remaining 0.1% (see Figure 3.5.2).

Figure 3.5.2: Headline inflation contributions



Source: CBSI

The domestic inflation component continued to be dominant driver despite slowing in pace from 7.8% in June 2013 to 5.7% in December 2013. Similar to headline inflation, much of the deceleration in the domestic inflation component can be attributed to slower growth in food, housing and utilities, and transport and communications as well as all other categories. Of the 2.1 percentage point fall, food accounted for 1 percentage point while housing and utilities explained 0.5 percentage points, and transport and communication contributed 0.3 percentage points to the fall. By December 2013, the 5.7% growth in the Domestic HRPI was explained by food, which accounted for 2.1%, followed by housing utilities at 1.7%, transport and communications, which explained 0.8%, drinks and tobacco at 0.5%, recreational, health, and other services at 0.3%, whilst household operations and clothing and footwear each accounted at 0.1%.

Furthermore, the imported headline inflation components declined from 1.4% in June 2013 to minus 0.9% as of December 2013. Of the 2.4 percentage point fall that has resulted in deflation in the imported inflation index, food accounted for 1.1 percentage point, housing and utilities contributed 0.3 percentage points of the fall, transport and communication explained 0.3 percentage points, while housing operations supported 0.2 percentage points of the fall. All other categories accounted for the difference. By December 2013, the 0.9% contraction in the Imported HRPI comprised of the falling food price index, which explained minus 0.5% of the overall outcome, followed by housing utilities, transport and communication, clothing and footwear and household operations, each accounting for 0.1%.

4. Outlook

Looking ahead, the global economy is anticipated to moderately improve from 3.0% in 2013 to 3.7% in 2014 and stabilising at 3.9% in 2015 (see Table 5.2). Much of the improved performance is forecast to come from the recovery in the advanced economies as well as improved growth prospects for the emerging market and developing economies and the developing Asia-Pacific region.

For the advanced economies, growth is expected to pick up further to 2.2% in 2014 with the US economy projected to grow by 2.8 % in 2014 and 3.0% in 2015, boosted by rebound in private consumption and private investment, residential construction, and highly accommodative monetary conditions. Meanwhile, growth in the euro area is forecast to recover from a 0.4% contraction in 2013 and into positive territory to 1% growth in 2014, led by an upturn in Germany, the EU's largest economy. Despite this, downside risks remain; high debt and financial fragmentation could hold back domestic demand and recovery in the region.

Growth in emerging market and developing economies is also projected to increase moderately to 5.1% in 2014, benefiting from stronger external demand in advanced economies and China, despite expectations that domestic demand will remain weak. Growth in China is forecast to stay unchanged at 7.7% in 2014, reinforced by the improvements in world trade and more optimistic growth prospects for the USA and European Union, key export markets for China. Large scale infrastructure spending, major new investment programs and robust consumer spending will also sustain growth in China. Similarly, India is expected to rally back in 2014 to 5.7% helped by higher export growth and stronger structural policies supporting investment.

In the Asia and the Pacific region, growth expectations remained flat at 7.2% in 2014 with a slight softening to 7.1% in 2015. Growth is expected to be driven by a rebound in East Asian exports as well as improved outlooks for the US and EU. However, declining commodity prices, may impact heavily on the outturn of commodity exporting countries within the region. In Australia, growth forecasts look upbeat with faster growth at 2.8% anticipated in 2014, backed by improved business conditions and increased private consumption. In New Zealand, growth is expected to expand by 3.0% in 2014 from 2.8% in 2013 as the economy gained further momentum from improved business confidence and investments, private consumption, and a favourable labour market outlook.

Inflation performance is likely to be mixed as consumer inflation in the advanced economies is expected to pick up whilst inflation in the emerging market and developing economies is anticipated to observe a slight fall to around 5.6%. In 2014, inflation for the US economy and the euro area is projected to pick up slightly to 1.8% and 1.3%, respectively. However, the projected inflation rates still persisted below the respective 2.0% targets of Federal Reserve and the European Central Bank as well as concerns over the potential impacts of both lower inflation and higher deflation on the region's growth recovery. In emerging market and developing economies, inflation for the region is projected to move broadly sideways at around 5% to 6% in 2014. Some reductions in price pressures are likely to be associated with expected fall in commodity prices during the year as well as the downward shift in growth. However, capacity constraints, weakening exchange rates, and strong domestic demand pressure might offset the downward pressure to some extent. In addition, Australia's annual inflation is expected to increase to an average 2.5% following price increases driven by growth in housing and transport prices in the second half of 2013. This is up from the 2.2% average exhibited in 2013. On the contra, the Reserve Bank of New Zealand projected inflation to fall slightly from 1.6% in 2013 to a 1.5% average in 2014, still within 1%-3% target band set by the reserve bank.

Global commodity prices are expected to weaken by a further 5.2%, extending the 1.4% fall witnessed in 2013. This reflects falling fuel prices in both fuel and non-fuel prices by 4.3% and 6.3% in 2014, respectively as global economic activity continued to grow moderately. Furthermore, the fall in international food prices, as indicated by the UN FAO's Food Price Index (UN FAO), is expected to accelerate, falling by 11% to 158 in 2014, on a favourable supply outlook. Projections for the international rice and wheat prices are anticipated to continue falling by 9% and 4%, respectively.

Turning to the domestic economy, GDP growth forecasts for 2014 anticipate a pick-up in economic activity from 3.2% in 2013 to reach 3.7% in 2014 and rising to 4.4% in 2015 (see Table 5.3). The higher growth projection reflect a recovery in the global economy and in major trading partners as well as strong performance in mining output, growth in the transport and communications sector, a positive outlook for construction, and a recovery in the agricultural sector. Growth will also be driven by sustained robust performances in fishing and manufacturing sectors, albeit slower than 2013 performances. On the contra, growth prospects will be dampened by the sustained deterioration in log output, which is forecast to gradually decline in the medium term.

Reserve money and broad money are expected to pick up significantly in 2014. Growth in M0 is forecast to increase from a 1% contraction in 2013 to 16% growth in 2014 and an 11% rise in 2015, on the back of strong growth in gross foreign reserves and the central bank's decision to halt further increases in the level of Bokolo bills available for tender. Consequently, growth in free liquidity is expected to follow a similar path to reserve money as CBSI does not currently envisage changes to the cash reserve requirement, given the current macroeconomic conditions. Therefore, excess liquidity is expected to increase from a contraction of 4% in 2013 to 24% growth in 2014 and 14% 2015. Furthermore, growth in private sector credit is projected to continue rising albeit slightly slower than the exceptional performance of 2013 with estimates forecasting 10% and 11% growth in 2014 and 2015, respectively.

The overall balance of payments position in 2014 is expected to improve though there are some components that are likely to observe some deterioration over the medium term. As a result of donor, investment, and other inflows, gross foreign reserves are anticipated to strengthen further by an average of 8% for the two next two years. On the contra, the current account deficit is expected to worsen in the coming years from an equivalent 10% of nominal GDP in 2013 to 15% in 2014 and stabilising at 15% in 2015. This is based on weaker outcomes in the trade in goods and services accounts as well as the income accounts despite the continued increase in the current transfers balance. Furthermore, the capital account, despite declining from 9% of nominal of GDP in 2013 to 8% of nominal GDP in 2014, it is expected to rise again to an equivalent 9% of nominal GDP by 2015.

Based on a balanced budget for 2014, the Government is expected to increase spending from $3,193 million in 2013 to $3,503 million in 2014 with recurrent expenditure rising from $2,253 million in 2013 to $2,862 million in 2014, amidst a reduction in development expenditure from $724 million to $641 million over the same period. This spending will be financed by an increase in recurrent revenue of $3,423 million and development grants of $80 million. The 2014 budget is equivalent to 48% of nominal GDP slightly higher than the 47% of nominal GDP witnessed in 2013.

Based on a range of CBSI inflation models, the inflation outlook in Solomon Islands is estimated to remain stable. For 2014, headline inflation rate is expected to average within the range of 4% to 6%. Meanwhile, imported inflation is expected to remain deflationary over the near term, reflecting the continued falls in international food and fuel prices. On the other hand, domestic inflation is anticipated to remain elevated over the same period. However, other risks to inflation could originate from a reversal in food and fuel prices, a sustained level of private sector credit growth, and exchange rate depreciation.

5. Monetary Policy Stance

Since the introduction of the CBSI Act 2012, the Central Bank of Solomon Islands has taken more measures to bring greater transparency and accountability in its operations to tackle domestic price instability. The CBSI is able combat inflationary pressure using its exchange rate and monetary policy instruments.

The exchange rate is adjusted intermittently in order to ensure that domestic inflation is contained while monitoring the impact of exchange rate policy on foreign reserves, competitiveness, and external debt.

The CBSI currently operates a managed peg to an invoice-basket of major trading currencies within a ±1% margin around a base rate. The current base rate is set against the US Dollar, which has maintained at $7.2833 per US$1 since June 2013 to March 2014. Prior to this, the base rate was slightly higher at $7.3561 per US$1 (see Table 5.2).

Through its Liquidity Management Framework, the CBSI attempts to influence inflation through affecting the monetary base via contractions and expansions in money supply. Currently, this is achieved using both direct and indirect monetary policy instruments, namely the Cash Reserve Requirement and Open Market Operations.

The Cash Reserve Requirement, a statutory requirement placed on commercial banks to hold a daily reserve of at least an equivalent of 7.5% of total deposit liabilities, has been maintained throughout the previous MPS period, and has remained unchanged since May 1999. As a result of growing deposit liabilities, the value of the cash reserve requirement is anticipated to increase by 8% from $209 million in September 2013 to $226 million by the end of March 2014[13](see Table 5.3).

Influencing the monetary base is also achieved through Open Market Operations, the auction of central bank-backed bills with short-term maturities to commercial banks. With the Cash Reserve Requirement witnessing no change over the September 2013 to March 2014 MPS period, the moderate contractionary monetary policy stance has mainly been represented by the actions taken by the CBSI to absorb excess liquidity through the sale of its Bokolo bills. Between September 2013 and March 2014, the total stock of auctioned Bokolo bills held by the commercial banks is expected to increase by 34% from $525 million to $705 million.

In terms of influencing the monetary base by reducing excess liquidity levels, the CBSI has made some advancement in its objective; excess liquidity is expected to fall by 5% from $1,001 million in September 2013 to $955 million by the end of March 2014. However, as witnessed in the monthly net movements in excess and total liquidity, the CBSI efforts are partially offset and sometimes more than compensated for by other, often more autonomous factors, explaining the less than 1-for-1 reductions in excess liquidity compared to growth in issued Bokolo bills stocked. As illustrated in Figure 3.1.1, despite the stock of Bokolo bills increasing over the period, some months have experienced opposite flows on total and excess liquidity as larger movements in net foreign assets, net position of the Government, and to a lesser extent, currency in circulation, often complicate the overall effect.

As a result, the net effect over the past six months has been one of containing average excess liquidity levels at around $980 million over the previous MPS period, lower than the

[13] Forecasted figures for March 2014.

average excess liquidity levels in the March 2013 to September 2013 MPS period of $1,040 million, albeit witnessing some variation. In spite of this, excess liquidity remained high and total liquidity continued to grow by 2% between September 2013 and March 2014. Meanwhile, latest data from the National Statistics Office has seen headline inflation in January 2014 falling to its lowest rate of 2.9% since February 2011 as a result of other factors other than monetary base growth.

Looking ahead to the next six months, inflation model forecasts and further softening in international commodity prices important to the Solomon Islands, all point to an easing in inflationary pressures. Taking these and other domestic factors into account such as faster economic growth, rising government spending, anticipated rises in utility prices and the recent pick-up in month-on-month inflation, average headline inflation is expected to be within a forecasted range of 4%-6% in 2014.

Given the recent developments and forecasted macroeconomic conditions, the CBSI is implementing a neutral monetary policy stance over the next six months. This will involve maintaining the current exchange rate regime, not altering the cash reserve requirement at 7.5%, and to halt the growth of auctioned Bokolo bills to current levels of $710 million. The CBSI will continue to monitor macroeconomic developments and will be ready to act if conditions encouraging domestic price stability change. Particular attention will be paid to the upward pressures that may originate from unanticipated increases in international commodity prices, unexpected acceleration in private sector credit, and rising government expenditure.

Table 5.1a: Inflation and Other Macroeconomic Indicators

INDICATOR*	2009		2010		2011		2012		2013	
	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec
Consumer Price Index										
Headline inflation (3mma)	9.4%	1.3%	1.0%	0.6%	7.3%	10.1%	7.1%	4.6%	5.2%	3.0%
- domestic component	*9.8%*	*2.1%*	*2.3%*	*0.7%*	*6.2%*	*12.8%*	*10.3%*	*6.3%*	*7.6%*	*-1.1%*
- imported ocmponent	*8.5%*	*1.2%*	*-0.5%*	*0.4%*	*9.0%*	*6.4%*	*2.7%*	*2.4%*	*1.4%*	*5.6%*
Annual inflation (12mma)	17.1%	7.1%	1.5%	1.0%	3.0%	7.4%	8.3%	5.9%	5.4%	5.4%
Balance of Payments ($millions)										
Gross Foreign Reserves	798	1177	1471	2144	2600	3034	3507	3668	3742	3909
% change	12%	47%	25%	46%	21%	17%	16%	5%	2%	4%
Current Account Balance	-529	-502	-782	-912	-436	-27	304	-298	-346	-322
- Trade in goods balance	-308	-289	-575	-527	-133	87	313	34	-162	-7
Capital Account Balance	91	125	243	159	225	314	260	450	341	263
Exports ($millions)										
Total exports	648	681	781	1023	1373	1801	1804	1824	1505	1706
% change	-26%	5%	15%	31%	34%	31%	0%	1%	-17%	13%
Imports ($millions)										
Total imports	955	970	1356	1550	1506	1714	1491	1791	1667	1713
% change	-17%	2%	40%	14%	-3%	14%	-13%	20%	-7%	3%
Of which are food imports	*226*	*260*	*254*	*379*	*230*	*413*	*295*	*389*	*340*	*386*
Of which are fuel imports	*229*	*188*	*257*	*200*	*383*	*398*	*398*	*445*	*463*	*437*
Import Cover (months)										
GFR minus govt ext. loan arrears	3.8	6.0	6.2	9.3	8.3	10.0	10.0	10.5	11.0	11.0
Prices										
Tapis Oil (daily average, USD per barrel)	56	75	80	85	116	119	123	115	114	111
CBSI Imported Food Price Index (end month)	141	155	155	137	170	170	178	178	177	168
Rice (Thai 5%, USD per mt, end month)	575	591	440	532	514	586	600	557	524	451
Wheat (US HRW, USD per mt, end month)	257	206	158	307	326	269	276	348	313	292
Fiscal Operations ($millions)										
Fiscal Deficit/Surplus	N/A	N/A	N/A	N/A	N/A	N/A	-16	-316	175	-80
- Actual Government expenditure (inc. donor expenditure)	N/A	N/A	N/A	N/A	N/A	N/A	1330	1418	1242	1856
Total Debt Stock	1430	1422	1356	1334	1240	1153	1092	1023	968	949
Debt to GDP ratio (%)	32.8%	32.7%	28.7%	28.3%	22.4%	20.9%	17.6%	16.5%	15.6%	15.0%
Global Economic Activity (annual growth)**										
Economic growth - Australia	1.4%		2.6%		2.4%		3.7%		2.5%	
Economic growth - New Zealand	-1.5%		1.9%		1.4%		2.7%		2.8%	
Economic growth - China	9.2%		10.4%		9.3%		7.7%		7.7%	
Annual Inflation - Australia	1.8%		2.8%		3.4%		1.8%		2.2%	
Annual Inflation - New Zealand	2.1%		2.3%		4.4%		0.9%		1.6%	
Annual Inflation - China	-0.7%		3.3%		5.4%		2.7%		2.6%	
Domestic Economic Activity										
Economic growth - Solomon Islands	-1.9%		7.9%		10.6%		3.3%		3.2%	
Employment (NPF contributors, end quarter period)	39141	38646	39302	41072	43367	42152	46196	48037	48346	48034
Production Index (overall)	44.5	47.3	49.7	65.0	74.5	115.1	101.4	98.6	81.4	100.4
Manufacturing Index (domestic goods, period average)	N/A	N/A	107.0	140.2	157.5	177.5	188.3	202.6	194.7	218.9
Exchange rate movement										
SBD units per USD (period average)	8.05	8.06	8.06	8.06	7.90	7.38	7.36	7.35	7.31	7.30
SBD units per AUD (period average)	5.72	7.02	7.21	7.62	8.16	7.61	7.60	7.64	7.42	6.73
NEER (2005=100) (IMF estimates, period average)	93.2	84.4	84.9	82.4	80.0	85.6	87.2	87.4	89.4	92.6
REER (2005=100) (IMF estimates, period average)	126.5	114.1	114.0	109.6	109.4	120.8	125.0	126.7	133.4	138.0

* Some data has been revised as a result of the availability of new or updated information.

** All 2009-2012 estimates are sourced from IMF World Economic Outlook Oct 2013. For 2013, revised growth and inflation estimates are sourced from:

- Australia GDP and CPI inflation: Focus Economics Feb 2014
- New Zealand GDP and CPI inflation: Focus Economics Feb 2014
- China GDP and CPI inflation: IMF World Economic Outlook Jan 2014 update

Table 5.1b: Monetary and Credit Aggregates

INDICATOR*	2009		2010		2011		2012		2013	
	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec	Jun	Dec
Monetary Base (M0), $millions	412	717	924	1263	1410	1659	1953	2054	1807	2034
% change	-6%	74%	29%	37%	12%	18%	18%	5%	-12%	13%
Narrow Money Supply (M1), $millions	1002	1128	1189	1304	1679	1873	2226	2396	2413	2533
% change	1%	13%	5%	10%	29%	12%	19%	8%	1%	5%
M2 Measure , $millions	1152	1260	1470	1565	1776	1983	2275	2484	2556	2680
% change	0%	9%	17%	6%	14%	12%	15%	9%	3%	5%
Broad Money Supply (M3), $millions	1631	1831	1912	2075	2365	2610	2924	3064	3156	3445
% change	4%	12%	4%	9%	14%	10%	12%	5%	3%	9%
Excess liquidity, $millions	15	227	383	637	711	894	1128	1161	959	969
% change	-58%	1443%	69%	66%	12%	26%	26%	3%	-17%	1%
Private Sector Credit, $millions	1299	1224	1220	1166	1171	1221	1209	1271	1398	1465
% change	2%	-6%	0%	-4%	0%	4%	-1%	5%	10%	5%
Interest rate margin	N/A	N/A	12.1%	10.7%	11.8%	10.0%	10.3%	10.5%	10.5%	10.4%

* Some data has been revised as a result of the availability of new or updated information.

Table 5.2 Medium-Term Macroeconomic Forecasts, 2014-2016

INDICATOR	2013 (p.)	2014 (e.)	2015 (e.)	2016 (e.)
Economic Activity (annual growth)				
Economic growth - Solomon Islands	3.2%	3.7%	4.4%	4.1%
Consumer Prices				
Headline inflation (3mma)	5.6%	4%-6%	4%-6%	4%-6%
Annual inflation (12mma)	5.6%	4%-6%	4%-6%	4%-6%
International Commodity Prices (World Bank forecasts)				
Tapis Oil	112	102	102	102
CBSI Imported Food Price Index (CBSI forecasts)	170	162	158	153
Rice (Thai 5%, USD per mt)	312	300	295	293
Wheat (US HRW, USD per mt)	506	460	450	447
Balance of Payments ($millions)				
Gross Foreign Reserves	3909	4274	4599	4883
Current Account Balance as a % of NGDP	-10%	-15%	-15%	-14%
Capital Account Balance as a % of NGDP	9%	8%	9%	7%
Import Cover (months) - GFR minus govt ext. loan arrears	11.2	10.9	10.5	10.2
Fiscal Operations ($millions)				
Total expenditure as a % of NGDP	44%	48%	46%	44%
Monetary and Credit Aggregates ($millions)				
Monetary Base (M0), $millions	2034	2365	2636	2887
Broad Money Supply (M3), $millions	3445	3654	4039	4534
Excess liquidity, $millions	1113	1379	1566	1716
Private Sector Credit, $millions	1465	1608	1777	1995

Table 5.3: Developments in Monetary Policy and Exchange Rate Policy Instruments

Indicator	Sep 2013	Oct 2013	Nov 2013	Dec 2013	Jan 2014	Feb 2014 (f)	Mar 2014 (f)
Inflation							
- Headline (3mma)	6.3%	5.5%	4.2%	3.0%	2.9%	N/A	N/A
- Month-on-month	-0.5%	-0.6%	-1.0%	-0.1%	4.3%	N/A	N/A
Exchange Rate Policy Indicators							
- Regime	Managed Peg	Managed Peg	Managed Peg	Managed Peg	Managed Peg	Managed Peg	Managed Peg
- Base rate	7.2833	7.2833	7.2833	7.2833	7.2833	7.2833	7.2833
- Margin	±1%	±1%	±1%	±1%	±1%	±1%	±1%
Monetary Policy Indicators							
- Monetary Base	3781	3809	3826	3909	3875	N/A	N/A
- Total Liquidity	1299	1273	1286	1280	1349	1299	1279
- Cash Reserve Requirement	209	215	217	218	228	225	226
- Precautionary Holdings	89	94	92	93	100	98	98
- Excess Liquidity	1001	965	977	969	1021	955	955
- Open Market Operations (issued)	525	525	540	600	665	705	705
- Net Foreign Assets	3524	3550	3707	3764	3786	3773	3765
- Net Position of Government	-1166	-1179	-1247	-1131	-1123	-1245	-1245
- Currency in Circulation	529	539	552	604	564	569	578
- Other Items Net	38	13	-35	-104	-41	71	89
- Treasury Bills	30	35	35	33	31	34	36

* using CBSI weekly data