CENTRAL BANK OF SOLOMON ISLANDS

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GENERAL NOTE

p	provisional
e	estimate
-	nil
n.a.	not available

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

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

GLOSSARY

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

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

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

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

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

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

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

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

Exports: Goods that a country sells abroad.

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

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

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

Imports: Goods that a country buys from abroad.

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

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

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

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

Private Sector Credit: Value of borrowings by private companies and individuals within the country.

Quasi Money: Total of time deposits and savings deposits.

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

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

Chapter I. OVERVIEW AND ANALYSIS

Overview

Global economic growth for 2016 remains positive but has been revised slightly downward amidst increasing market uncertainties. According to the latest International Monetary Fund (IMF) World Economic Outlook (WEO) update[1], global growth for 2016 was marked down by 10 basis points relative to its April 2016 forecast to 3.1%. This growth outcome, albeit lower than expected is supported by improvements in large emerging markets and some advanced economies. Nevertheless, existing downside risks to global financial markets is expected to rise in the aftermath of the 'Brexit' vote.

Growth in the advanced economies was forecast to be at 1.8%, a 10 basis point downward revision from April forecast and also 10 basis point lower than growth in 2015. The revision was made in response to the anticipated repercussions that Brexit may have on market and financial conditions. As a result, among the advanced economies, the United Kingdom showed the largest revision with growth scaled down by 20 basis points in 2016 and close to a 1 percentage point downward revision in 2017. Likewise, growth in the United States was downgraded to 2.2% in 2016, 20 basis points lower than the April forecast and 30 basis point below 2015 growth. This outcome reflected weakened business strength and waned manufacturing investments that resulted from low oil and gas prices. Furthermore, weak external demand, exchange rate appreciation and somewhat tighter financial conditions weigh heavily on recovery. However, on the positive note, the negative impact of Brexit is projected to be muted for the US economy.

Turning to the Japanese economy, economic growth was revised down to 0.3% from 0.5% forecasted in April 2016. The downward revision reflected weaker domestic demand and consumption emanated from increase in consumption tax in early 2014. Moreover, further strengthening of Japanese yen in recent months took a toll on growth for both 2016 and 2017.

Growth in the euro area is revised up slightly by 10 basis point to 1.6% relative to the April 2016 forecast given outcomes in the first half of the year. However, high frequency data indicated some moderation ahead stemming from potential impact of uncertainty on consumer and business confidence and potential bank stress. The brunt of the impact of Brexit is not expected to be felt in the euro area this year as negotiation will likely to drag on for a period of 2 years. As a result, growth forecast for 2017 is expected to fall by 20 basis points to 1.4%.

In the emerging and developing economies, growth is expected to remain unchanged relative to April 2016 outlook. Growth in 2016 and 2017 are estimated at 4.1%and 4.6%, respectively. The Chinese economy is recovering with improved near term outlook on the back of policy support that strengthens domestic demand. As a result, growth for 2016 was revised up by 10 basis points to 6.6% albeit lower than the growth of 6.9% recorded for 2015. The direct impact of the U.K referendum is likely to be limited in light of China's low trade and financial exposure to the United Kingdom.

Turning to the country's closest trading partners, Australia and New Zealand expected moderate growths in 2016. The Australian economy[2] envisaged a growth of more than 3% over the year to the March quarter. However, some indicators started showing moderation in the second quarter of 2016 as contributions from mining investment to GDP declined. For New Zealand[3], growth is expected to expand by 2.5% in 2016, 10 basis point up from the previous forecast of 2.4% in the first quarter. This growth is supported by strong net immigration, construction, tourism, accommodative monetary policy, robust private consumption and fixed investment. These outweighed the weak exports, arising from low commodities prices, subdued demand and an appreciation of the New Zealand dollar. Growth for 2017 is forecast to grow at 2.5%.

In terms of inflation, 2016 forecasts show that most advanced and emerging economies are projected to remain below central bank targets in 2016. Inflation in advanced economies is forecast to remain below 0.7% in 2016. Much of the inflation expectations in the United States and Euro area has coincided with the decline in oil prices that contributed to low headline inflation. Meanwhile inflation for emerging and developing economies is expected to pick up slightly by 10 basis points to 4.6% in 2016, from 4.7% in 2015 reflecting rebound in commodity prices.

1 All statistics in this section obtained from IMF World Economic Outlook, July 2016 unless otherwise stated.

2 http://www.rba.gov.au/publications/smp/2016/aug/

3 http://www.focus-economics.com/countries/new-zealand

Closer to home, inflation rates in Australia[4] and New Zealand are expected to remain at low levels. These reflect downward pressures from energy prices and subdued underlying inflationary pressures.

Domestic economic outcomes in the second quarter showed positive performances across key sectors and remain broadly firm. The production index, which measures major commodities performances, strengthened by 16% to 94 points compared to the 17% decline in the first quarter of 2016. The turnaround was attributed to log production that increased by 24%, 11% rise in crude palm oil output, cocoa production that more than doubled, and copra production which increased by 5%. The increases outweighed the 14% contraction in fish catch during the quarter.

Approved foreign direct investment applications recorded an increase of 39% against the previous quarter to reach 53 applications. The manufacturing index also improved by 2% to 266 points, supported by improvements in processed tuna for export, and production of biscuits and flours. These more than offsets the falls in canned tuna production destined for domestic markets, production of soft drinks and tobacco in the second quarter. Labour market conditions in June quarter, measured by the number of Solomon Islands National Provident fund (SINPF) contributors, showed an improvement of 1% to 47,255 active members against the previous quarter.

Headline inflation as measured by the 3 months moving average (3mma) moderated to 2.9% in June quarter from 3.9% in the previous quarter. The slowdown was driven by both imported and domestic inflation that declined to 0.5% from 2.7% and from 4.6% to 4.3%, respectively. In terms of inflation contributions by category, food index accounted for bulk of the increase, rising from 4.9% to 5.1%, drinks and tobacco slowed to 14.8%, albeit still on high side while other components remained modest. Core inflation fell slightly from 1.3% a quarter ago to 1.0% in the second quarter.

The balance of payments position of the country deteriorated in the June quarter to a deficit of $47 million. This reversed the remarkable surplus of $109 million recorded in the previous quarter. The unfavourable position came on the back of a widening current account deficit and financial accounts deficit that combined to outweigh the capital accounts surplus. Trade in goods improved to a surplus of $59 million while secondary income surplus narrowed to $92 million. However, these were outweighed by negative balances in services and primary income accounts. As a result, the gross foreign reserves slipped by 1% during the quarter to $4,223 million, equivalent to cover 10.3 months of imports of goods and services.

Monetary aggregates registered broad-based growths in the second quarter of 2016. Reserve money increased by 3% to $2,344 million following increases in ODCs' call account and currency in circulation. Similarly, narrow money rose by 6% to $3,500 million due to the build-up of transferrable deposits held with depository corporations. Other deposits also recorded slight increases during the quarter. As a result, broad money supply grew by 5% to $4,432 million with total liquidity rising to $1,603 million. The ODC's indicative weighted average interest rate margin remained at 9.8% in June 2016. Meanwhile, the indicative weighted average interest rates on all deposits offered by ODCs continued to ease to 0.14% in the second quarter.

On fiscal developments, Central Government recorded a deficit of $147 million in June quarter compared to $72 million deficit in the previous quarter. The outcome reflected higher expenditure than revenue collected during the quarter. Expenditure expanded by 32% to $1,016 million driven by operations and development spending. This is more than offsetting the 24% increase in total revenue of $869 million recorded in the second quarter. The increase in total revenue was supported by all major tax categories including budget support that increased by more than threefold. The Central Government debt stock fell marginally by 2% in June quarter to $669 million from a revised $681 million in the first quarter of 2016. This outcome was due to debt repayments made to several external creditors during the quarter.

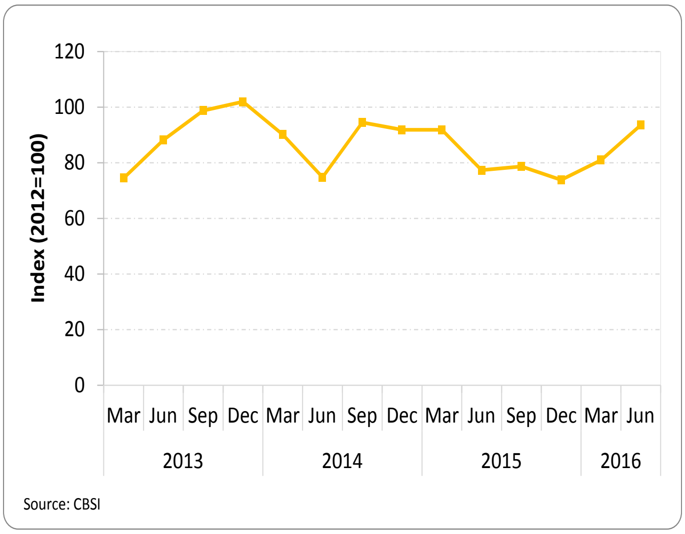
[4] http://www.rba.gov.au/publications/smp/2016/aug/international-economic-developments html

Chapter II. DOMESTIC ECONOMY

Production Index

Domestic economic activities, as measured by the CBSI production index rebounded in the second quarter of 2016 with the overall production index increasing by 16% to 94 points from 81 points in the preceding quarter (see Figure 2.1). Favourable performances in the logging and cocoa industries during the quarter were mainly responsible for this improved economic momentum with log growing by 24% and cocoa by 77%. During the quarter, the Logging and non-logging indexes showed a 7% and 61% growth respectively. Sustained increases in palm oil productions also contributed to the growth.

Figure 2.1: Production Index

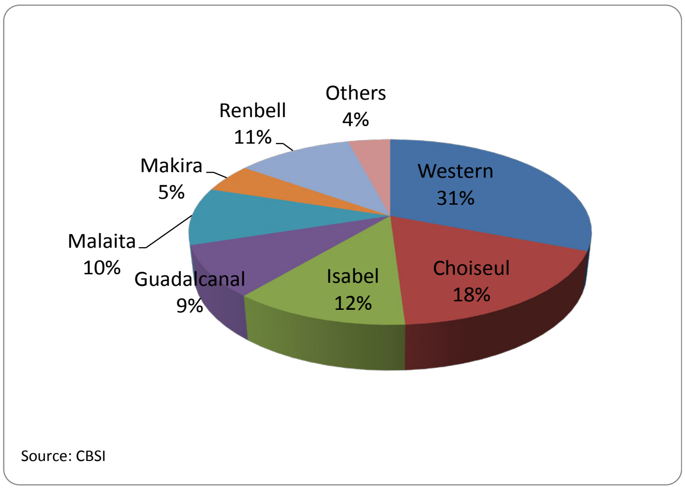


Logs

Log export volumes used as a proxy for production, rebounded in the second quarter of 2016 by 24% to 709,372 cubic meters, taking the total output for the first six months of 2016 to 1.283 million cubic meters, 206,000 cubic meters higher than the corresponding 2015 output level.

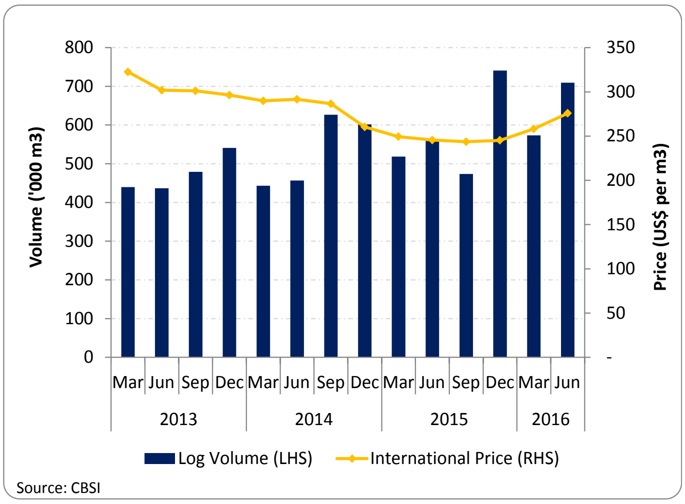
Log production by province showed that the Western province remained the largest contributor of the total output at 31%, followed by Choiseul province with 18%, Isabel 12%, Renbell represented 11%, Malaita 10%, Guadalcanal 9%, Makira 5%, while Temotu and Central provinces contributed 2% each. (See Figure 2.2).

Figure 2.2: Log Export by Provinces



The average international log price continued to increase by 5% to US$276 per cubic meter from US$258 per cubic meter in the previous quarter (see Figure 2.3).

Figure 2.3: Volume and Average Price of Logs

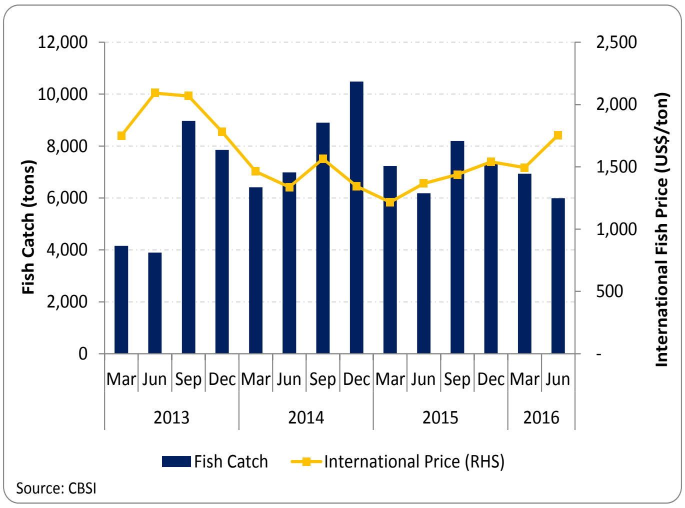


Fish

Fish catch remained subdued this quarter declining by 14% to 5,990 tons from 6,935 tons in the previous quarter. Total fish catch to date reached 12,925 tons, 4% below the 2015 mid-year catch. Lesser fishing activities due to unscheduled boat maintenance combined with unfavourable weather conditions during the quarter weighed on this low outcome.

The average international price of fish bounced back by 18% to US$1,755 per ton from a 3% fall recorded in the previous quarter (see Figure 2.4).

Figure 2.4: Fish Catch and Average Price

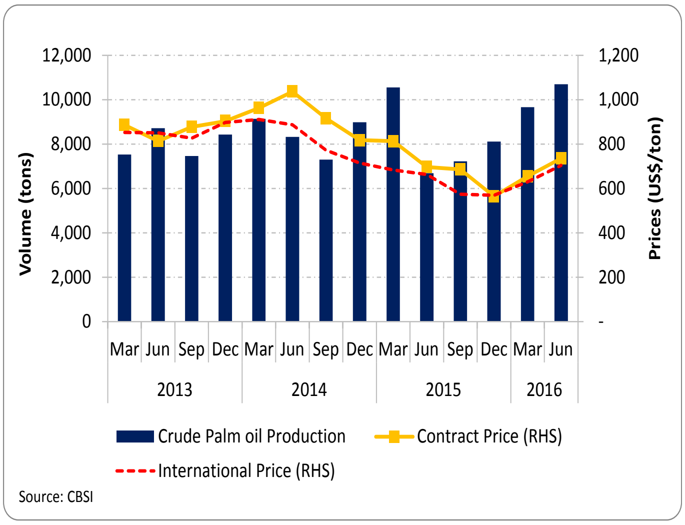


Nevertheless, canned-tuna production rose by 5% this quarter to 177,975 cartons from 169,278 cartons in the previous quarter buoyed in part, by increased stockpiling of fish stock and improved production process at the cannery. Fish loin also increased by 5% to 250,541 cartons against the previous quarter reflecting sustained high demand from Europe and the United States, the main export destinations. Fishmeal rose by 15% to 17,820 cartons at the end of the quarter.

Palm Oil

Production of all palm oil products remained upbeat during the quarter with fresh fruit bunches rising by 13% to 44,252 tons against the previous quarter. As a result of this increase, crude palm oil rose by 11% to a record high of 10,702 tons.

Figure 2.5: Palm Oil Production, Inernational and Contract Prices



Palm kernel oil also registered a record high production level of 1,045 tons from 954 tons in the previous quarter. Year to date output for crude palm oil and palm kernel oil were 20,372 tons and 1,999 tons respectively, above the 2015 mid-year production by 18% and 0.4% respectively.

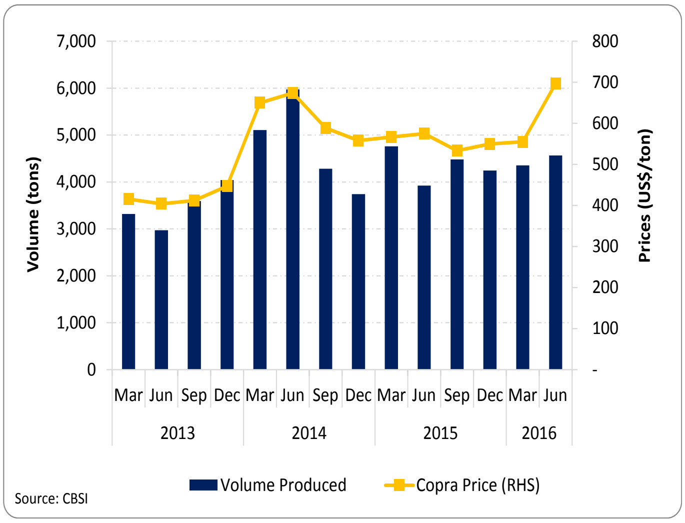
Average contract prices for crude palm oil rose 13% to US$736 per ton from US$654 per ton. Similarly, contract prices for palm kernel oil surged by 6% to US$1,443 per ton from US$1,360 per ton (see Figure 2.5).

Copra

Copra production rose by 5% to 4,565 tons in the second quarter in response to sustained high international and contract prices over the quarter. Year to June production stood at 8,918 tons, 236 tons higher than the same period in 2015.

In terms of production by province, Central province remained the lead contributor of total output this quarter at 1,785 tons, followed by Guadalcanal province with 1,165 tons surpassing Western province's output of 469 tons, Choiseul produced 429 tons, Makira recorded 414 tons, whilst Isabel and Temotu provinces registered 122 tons and 31 tons each respectively during the quarter.

Figure 2.6: Copra Production and Contract Prices



In terms of prices, average international copra price rose 16% to US$1,019 per ton from US$855 per ton in the first quarter. In contrast, contract prices received by local copra exporters decreased by 16% to US$464 per ton from US$555 per ton in the previous quarter (see Figure 2.6). Domestic prices received by local farmers on the other hand, surged markedly by 28% from $3.70 per kilogram to a record high of $4.80 per kilogram.

Cocoa
Following three consecutive quarters of decline, cocoa production recovered significantly by 77% to 908 tons in the second quarter from 513 tons in the previous quarter. The improvement was attributed to the high cropping season particularly in the month of April. However, the year to date production was 1,421 tons, 49% lower than the 2015 half year production, particularly reflecting low production in the months of May and June.

Cocoa production by province showed Guadalcanal province recorded the highest share of output at 45% during the quarter, followed by Malaita's with 38%, Makira 15% while other provinces makeup the remaining 2%.

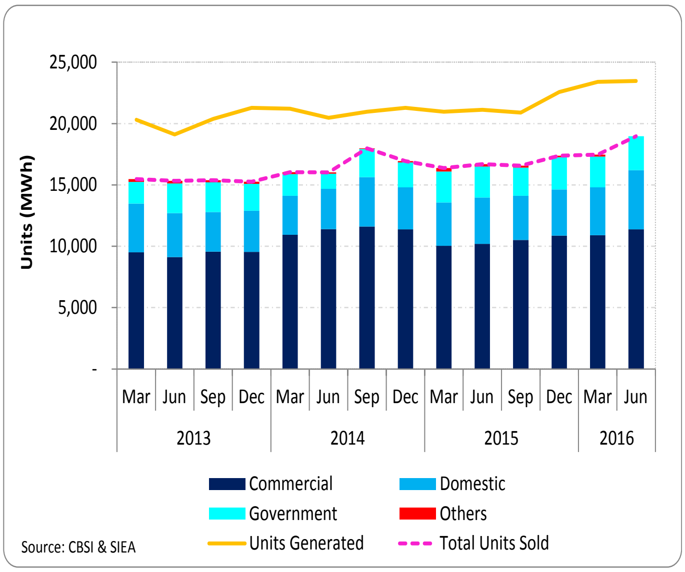
In terms of prices, average contracted export prices improved to GBP 1,831 per ton from GBP 1,830 per ton while domestic prices remained at $17 per kilo during the quarter.

Employment
The number of Solomon Islands National Provident Fund (SINPF) contributors, as a partial indicator for labour market conditions moderated this quarter after recording a marginal growth over the last quarter. The average number of contributors decreased marginally to 55,755 from 55,842 in the previous quarter. The 4% fall in the slow active category from 8,882 contributors to 8,501 contributors during the quarter was responsible for the reduction. In contrast, total active contributors rose from 46,959 contributors to 47,255 contributors at the end of the quarter.

Energy
Units of electricity generated by the Solomon Islands Electricity Authority (SIEA) expanded by 0.3% this quarter to 23,474 Megawatt hours (MWh) following a 4% growth recorded last quarter. Consequently, electricity sold surged 9% to 18,973 MWh from 17,469 MWh in the previous quarter. Electricity sales to the domestic, commercial and the government categories rose 23%, 4%, and 11% respectively during the quarter (see Figure 2.7)

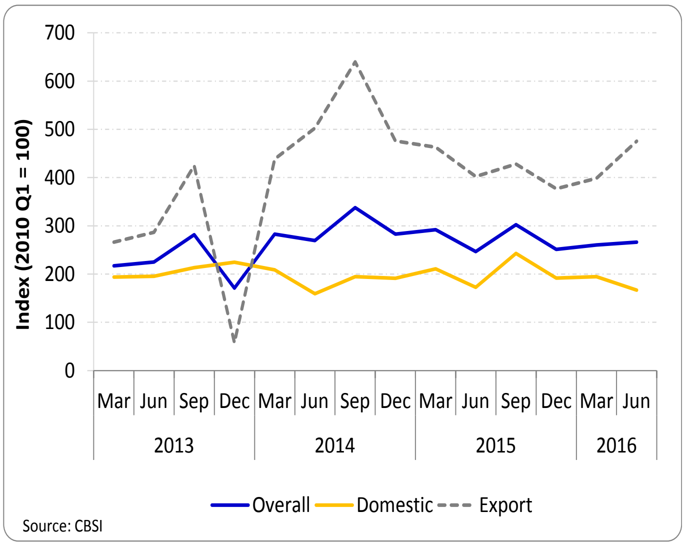
Total units of electricity produced to date rose by 11% above the corresponding period in 2015 to 46,870 MWh. Similarly, total year to date sales reached 36,442 MWh, 10% higher than the similar period of 2015. Unsold units for the quarter fell by 24% compared to a 14% rise last quarter. In line with this fall, the ratio of unsold units to units generated rose to 19% from 25% in the past quarter.

Figure 2.7: Units of Electricity Generated and Sold



Manufacturing
Manufacturing activities, as measured by the CBSI manufacturing index, rose by 2% to 266 points from 260 points in the previous quarter. The increase was mainly attributed to a 19% rise in canned tuna production for exports during the quarter which resulted in a 19% surge in the tuna index for exports at end June. A 5% increase in loin production during the quarter also contributed to the rise.

Figure 2.8: CBSI Manufacturing Index



In contrast, the index for the domestic market declined by 14% to 167 points reflecting falls in solbrew, tobacco and canned tuna (for domestic consumption) productions by 23%, 1% and 10% respectively during the quarter (see Figure 2.8).

Building Permits
The Honiara City Council (HCC) approved 47 building permits in the second quarter of 2016, an increase of 18% from 57 permits in the first quarter. Of the total permits approved, 27 were for residential compared to 30 in the previous quarter. For commercial buildings, 9 permits were issued against 12 previously whilst 11 permits were approved for the other category compared to 15 a quarter ago. In terms of value, the total value of approved permits this quarter dropped by 3% to $28 million compared to $29 million in the previous quarter.

Visitor Arrivals
Visitor arrivals remained buoyant in the second quarter rising by 26% to 9,572 visitors from 7,575 visitors in the first quarter. The growth was underpinned mainly by gains in sea arrivals which benefitted from strong on-going promotional and marketing efforts alongside attending of major travel industry events in key source markets by the Solomon Islands Visitors Bureau (SIVB). To a lesser degree, improved international flights to the country also contributed to the growth. Reflecting these developments, cruise arrivals increased 53% to 3,893 visitors whilst air arrivals recovered from last quarter's 15% fall to grow 13% to 5,679 visitors at the end of the quarter.

Visitors by country revealed Australia remained the largest source market representing 43% (2,445 visitors) of the total visitors, followed by United States and New Zealand both recording 8% each of the total share with 444 visitors and 439 visitors respectively whilst Fiji recorded 365 visitors at 6% and Papua New Guinea 4% with 243 visitors. The other countries make up the remaining 16%.

In terms of visitor by purpose, the largest number of visitors was dominated by the holiday and vacation category with 1,831 arrivals overtaking the business and conference category's 1,610 visitors, followed by Others category accounting for 1,374 visitors and 808 visitors for the visit friends and relatives' category.

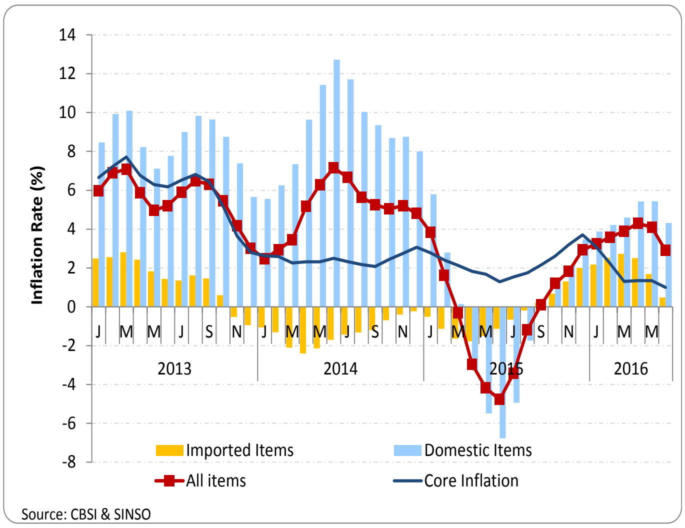
Foreign Investment
Investment activity improved in the second quarter as indicated by the foreign direct investment applications approved during the quarter. Total investment applications approved amounted to 53 applications worth $581 million compared to the previous quarter's 12% fall. On a sectoral basis, the wholesale and retail services accounted for the majority with 22 applications (42%), followed by other services with 14 applications (26%), mining, tourism and the construction sectors registered 3 applications (6%) each, manufacturing, transport and communication, consultancy and electrical recorded 2 applications (4%) each while forest, fisheries and wild life received one application (2%) each.

In terms of provincial distributions, Honiara accounted for the bulk of the investment during the quarter registering 48 applications, followed by Western province with 3 applications and Malaita and Isabel provinces recorded an application each.

Inflation
Headline inflation, measured by a 3 months moving average, eased from 3.9% a quarter ago to 2.9% in the second quarter. The fall was attributed to slower price increases in both imported and domestic goods during the quarter. Imported inflation decreased from 2.7% to 0.5% whilst domestic inflation fell from 4.6% to 4.3%.

Falls in the recreation, household operations and the food categories were responsible for the slowdown in the imported inflation whilst decline in the food and drinks & tobacco categories were the main driver behind the deceleration in domestic inflation (see Figure 2.9)

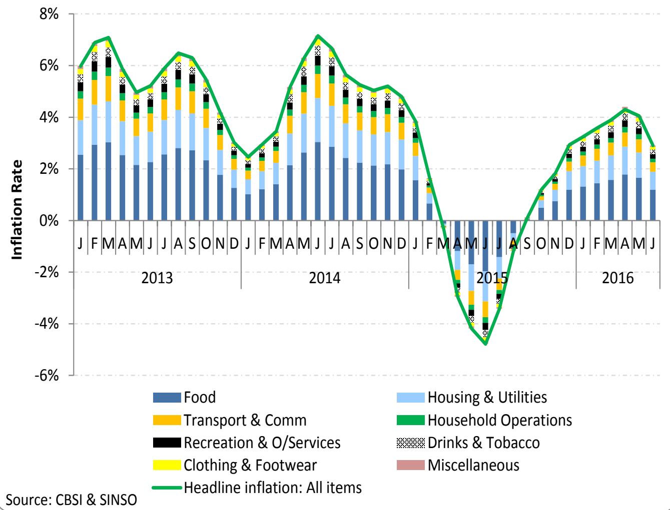
Figure 2.9: Headline and Underlying Inflation Rate (3mma)



Source: CBSI & SINSO

Of the overall inflation rate of 2.9%, food accounted for 1.2%, followed by housing & utilities at 0.7%, transport and communications 0.4%, whilst 0.6% was shared by the remaining categories (see Figure 2.10).

Figure 2.10 Contributions to Headline Inflation



Source: CBSI & SINSO

Honiara Retail Fuel Price

The average domestic fuel price dropped from $7.75 per litre to $7.68 per litre in the second quarter. The fall reflected a 20 cents fall in diesel price from $7.20 per litre to $7.00 per litre and a 28 cents contraction in petrol price from $7.78 per litre to $7.50 per litre during the quarter. In contrast, kerosene price increased by 26 cents to $8.54 per litre from $8.27 per litre a quarter earlier.

Chapter III. BALANCE OF PAYMENTS

The overall balance of payments position in the June quarter of 2016 swung sharply to a deficit of $47 million, reversing the surplus of $109 million in the previous quarter. This downturn stemmed from the widening deficit in the current account amidst a decline of the surplus in the 'capital and financial account'. As a result, the level of gross foreign reserves fell by 1% during the quarter to $4,223 million and was sufficient to cover 10.3 months of imports of goods and services.

Table 3.1 Balance of Payments Statistics

	2015			2016	
	Jun Qtr	Sep Qtr	Dec Qtr	Mar Qtr	Jun Qtr
A. Current Account	5	-268	68	-95	-139
Goods	-53	-171	123	11	59
Services	-152	-136	-196	265	-203
Primary Income	-31	-51	-57	14	-87
Secondary Income	242	90	198	173	92
B. Capital & Financial Account	352	-41	16	171	87
Capital	153	52	82	72	110
Financial Account 1(excl. reserve asset) 1/	199	-93	-86	99	-23
C. Net errors and ommissions	24	-6	-36	33	4
D. Overall BOP position (+ve=Surplus)	382	-315	48	109	-47
F. Financing	-382	315	-48	-109	47
Official reserves (-ve=increase)	-376	318	-36	-112	59
IMF program (-ve=decrease)	-6	-4	-12	3	-12
Position of gross foreign reserves at end	3,784	4,026	4,390	4,275	4,223
Months of import cover of goods and services	9.5	10.2	11.1	10.2	10.3

1/ The financial account in BOP analytical presentation shows reserve asset separately in Item F. Under BPM6, the financial account includes reserve assets.

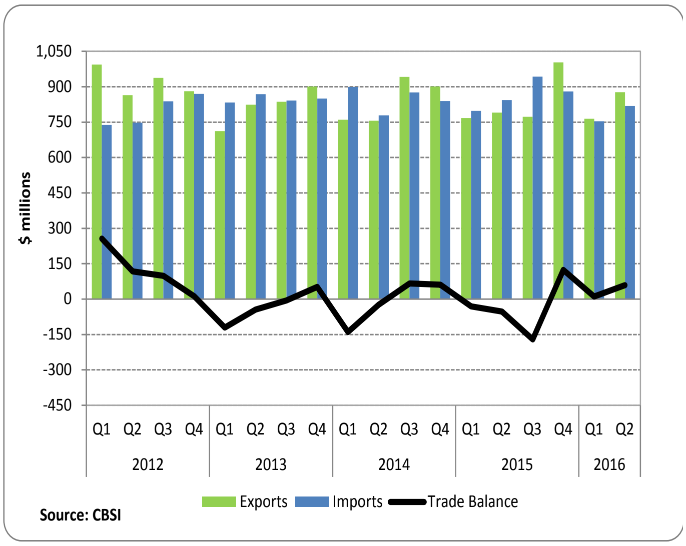
Source: CBSI

The current account deficit deteriorated to $139 million during the quarter from $95 million in the preceding quarter. This was largely driven by the reduction of the surplus in secondary income, the widening of the deficit in primary income, and the large structural deficit in the trade in services. The negative outcome outweighed the improvement of the surplus in the trade in goods.

On the other hand, the capital and financial account (excluding reserve assets) fell to an $87 million surplus during the quarter from a $171 million surplus in the previous quarter. This was due to higher outflows from the financial account which lessened the impact of the rise in inflows into the capital account.

The surplus in the trade in goods balance improved to $59 million from $11 million due to the sizeable 15% growth in exports to $877 million. This more than offset the 9% growth in imports to $818 million. The positive outcome in exports during the quarter was attributed to the rise in production and favourable world market prices of the country's three major export commodities. Receipts in the agriculture sector doubled to $157 million on the back of rising production and buoyant export prices for cocoa and palm oil. While, the fisheries export receipts grew by 16% to $72 million primarily due to a rise in fish loin exports and the forestry exports increased by 2% to $600 million from the upturn in round log and sawn timber exports.

Figure 3.1: Trade in goods



The growth in imports during the quarter stemmed from the increase in imports of food, machinery and transport equipment, basic manufactures, and miscellaneous goods. Food imports increased by 5% to $229 million, machineries by 2% to $232 million, basic manufactures by 46% to $151 million, and miscellaneous items by 48% to $77 million. On the other hand, Chemicals fell by 28% to $59 million owing to a decrease in shipment of medicines during the period. Meanwhile, mineral fuel remained the same at $127 million despite an uptick in global fuel prices and was due to the accumulation of fuel imports in the previous quarters.

Trade in services

Trade in services posted a deficit of $203 million in the June quarter from a deficit of $265 million in the previous quarter. Although this was a relative improvement from the previous period, the deficit was still significantly higher than two quarters ago or the same quarter in 2015. The result during the period was mainly due to the reduction in the travel and other services deficits. Travel narrowed from a deficit of $82 million to a deficit of $20 million, owing to an expected rise in personal travel receipts during the peak season for tourists. While, the deficit in other services fell from $99 million to $80 million due to the decrease in business services payments and an increase in receipts related to government services. However, transport services deteriorated during the period from a deficit of $84 million to a deficit of $103 million. This resulted from the rise in air transport payments associated with more residents travelling on foreign carriers that more than offset the rise in air transport receipts.

Primary income account

The deficit in the primary income account significantly widened from $14 million to $87 million. This was attributed to the deterioration in all primary income categories. Investment income slid from a $78 million deficit to a deficit of $123 million due to an increase in direct investment payments by foreign companies during the period. Other primary income associated with fishing rights licenses also declined from $73 million to $47 million. The drop in fisheries licenses was due to seasonal weather conditions that saw less foreign fishing boats operating in the country's Exclusive Economic Zone. Meanwhile, compensation of employees widened slightly to an $11 million deficit in the second quarter from a $9 million deficit in the previous quarter.

Secondary income

The secondary income surplus narrowed to $92 million during the quarter from $173 million in the preceding quarter. This resulted primarily from a 27% fall to $119 million in transfers to general government, particularly from aid in cash and technical assistance. Additionally, private sector transfers recorded an outflow of $27 million from an inflow of $10 million due to higher outward remittances by foreign workers along with a marked fall in inflows to churches and Non-Governmental Organisations during the period.

Capital

The capital account surplus increased to $110 million in the June quarter from $72 million in the March quarter. This came on the back of an increase in donor-funded capital infrastructure projects including the completion of the second international wharf in Honiara and road rehabilitation activities around the country.

Financial Account

The financial account declined significantly to a deficit of $23 million in the second quarter from a surplus of $99 million in the previous quarter. This resulted from a sizeable outflow of $97 million from other investments compared to the inflow of $53 million in the previous quarter. The turnaround represented repayments of foreign liabilities including government external debt servicing and also payments by commercial banks to increase their holdings of foreign currency assets. Portfolio investment also posted an outflow of $4 million from inflows of $3 million in the previous month. On the other hand, direct investments, in particular inward foreign direct investment almost doubled to $77 million from $43 million due to higher reinvestment earnings recorded during the quarter.

International Investment Position (IIP)

The international investment position widened from a $343 million deficit in the first quarter to a deficit of $398 million in the second quarter. This was due to the 1% increase to $5,607 million in the stock of financial liabilities and the slight 0.2% fall to $5,209 million in the stock of financial assets. The growth in financial liabilities came from the rise in direct investment liabilities by 2% to $4,473 million and offset a 4% decline in other investment liabilities to $1,134 million. While, the outcome in financial assets stemmed from the $52 million fall in reserve assets to $4,223 million. This more than offset the rise in direct investment assets by 1% to $401 million, portfolio investment assets by 3% to $114 million and other investment assets by 8% to $470 million.

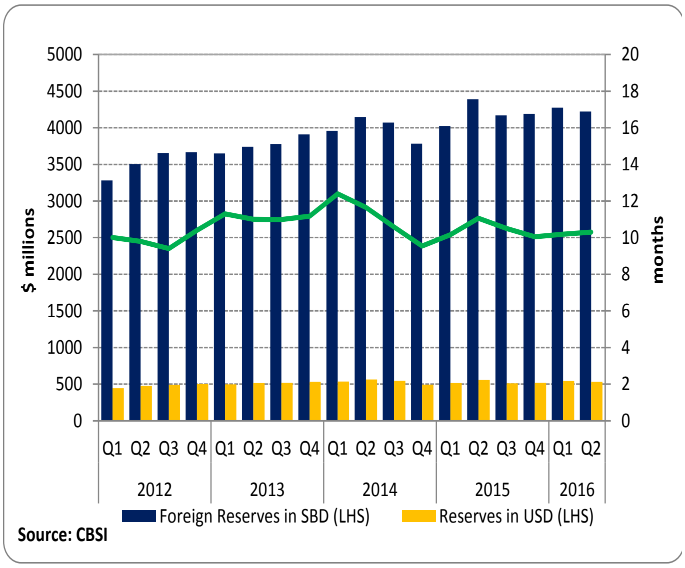
Table 3.2 Gross External Debt Statistics (SBD million)

	2015		2016	
	Sep Qtr	Dec Qtr	Mar Qtr	Jun Qtr
Gross External Debt Position	2,096	2,099	2,144	2,119
(i) General Government	684	655	638	625
(ii) Central Bank	286	235	251	246
(iii) Deposit - Taking Corporations	84	112	151	131
(iv) Other Sectors 1/	134	141	135	132
(v) FDI: Intercompany Lending 1/	907	957	968	985

1/ provisional
Source: CBSI

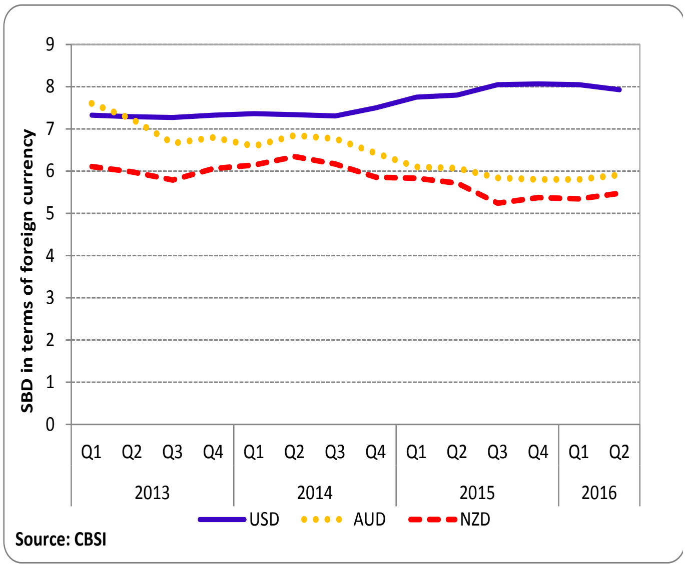
The gross external debt stock declined by $28 million to $2,119 million at end June 2016. This outcome came on the back of a 2% fall in general government debt to $625 million that was associated with government's debt servicing of its long term loans. External liabilities held by the Central Bank and deposit-taking corporations also declined by 2% to $246 million and by 14% to $131 million respectively. While, external debt by other sectors (that include non-financial corporations and other financial corporations) dropped by 2% to $132 million during the period. However, foreign direct enterprises' liabilities held with their parent companies abroad rose by 1% to $985 million and was associated with the increase in intercompany trade credits.

Figure 3.2: Gross Foreign Reserves



Reserve asset flows deteriorated from a $112 million surplus in the March quarter to a deficit of $59 million in the June quarter. This negative outcome was due to the financing of the $47 million deficit in the balance of payments position and the scheduled settlement of IMF loans during the period. Accordingly, the country's stock of gross foreign reserves at the end of June fell by 1% to $4,223 million. This level of reserves was equivalent to 10.3 months of import cover.

Figure 3.3: Exchange Rates



The Solomon Islands dollar (SBD) strengthened against the United States dollar (USD) in the second quarter by 1.7% to an average $7.93 per USD. Aside from a 1.6% appreciation against the British Pound to $11.36 per GBP, it weakened against the other major tradable currencies. The SBD depreciated by 1.8% against the Australian dollar to $5.91 per AUD, and by 2.4% against the New Zealand dollar to $5.48 per NZD. It also went down by 4.8% against the Japanese Yen to $7.34 per 100 JPY and by 1.1% against the EURO to $8.97 per EUR.

In terms of the 2012-based trade weighted index (TWI), the SBD appreciated by 1.61% to a quarterly average index of 107.6 in the June quarter. However, the nominal effective exchange rate (NEER) depreciated by 1.3% to an index of 100.4 on the back of the SBD's nominal fall against most of the bilateral currencies. Meanwhile, the real effective exchange rate (REER) strengthened by 1.1% to an index of 154.8 and was associated with the relatively higher inflation in the Solomon Islands compared to its trading partners.

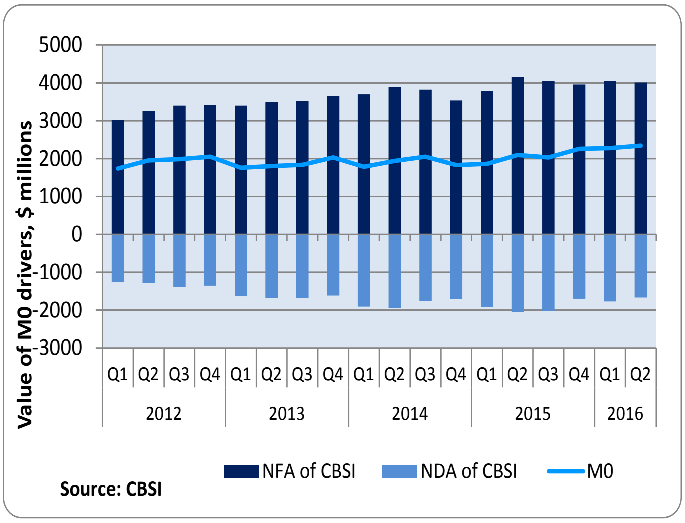
Chapter IV. MONEY AND BANKING

Developments in the key monetary aggregates at the end of June 2016, saw a broad-base growth in reserve money (M0), narrow money (M1) and broad money (M3). Total liquidity in the banking system also increased this quarter resulting in excess liquidity rising by 2% to $ 1,156 million. Further to that, private sector credit (PSC) continued to increase this period at a slower rate compared to the previous quarter mainly through financing by loans. Other depository corporations (ODCs) weighted average interest rate margin remained unchanged due to weighted average interest rate on lending continued to retain at the same level. Whilst the weighted average interest rate deposits fall at the end of the period.

Reserve Money

Reserve money increased further by 3% to $2,344 million at the end of the June quarter, from a marginal growth of 1% in the first quarter of 2016. This outcome was driven by rise in its components of which both ODCs' call deposits balance held at CBSI and currency in circulation issued increased by 2% to $1,585 million and 4% to $751 million respectively.

Figure 4.1: Major drivers of Reserve Money



Despite the increase in M0 as reflected in its components, the sources of growth for M0 declined, as CBSI's net foreign assets (NFA) marginally declined by 1% to $4,012 million, underpinned by rise in foreign exchange outflows. Likewise, the net domestic assets (NDA) of CBSI fell by 6% to net liability of $1,663 million, reversing the 4% increase in net liabilities witnessed in the first quarter. This resulted from a decrease in claims of Central Government, mainly from drawdowns in government deposits with CBSI. Year-on-year growth saw M0 grew by 12%.

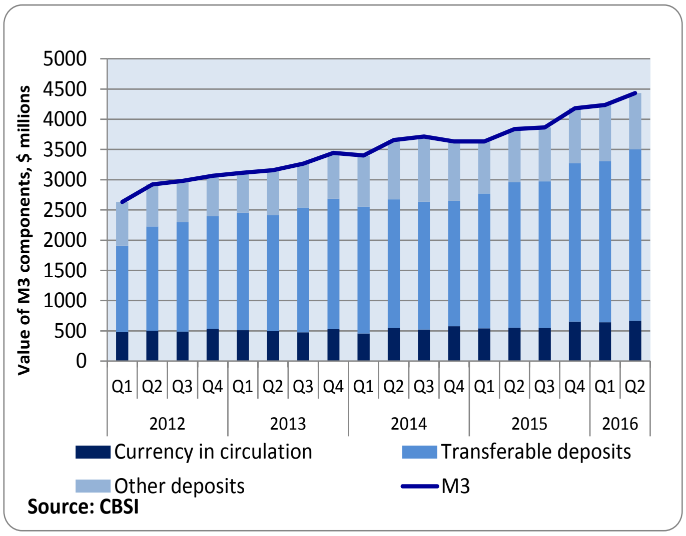
Narrow Money

Narrow money (M1) grew by 6% to $3,500 million this quarter, following a marginal growth of 1% in the previous quarter. This resulted from the build-up in both transferable deposits held with Depository Corporations (DCs) and currency in circulation by 6% to $2,829 million and 4% to $671 million, respectively. The increase in DC's transferable deposits came from a rise in transferable deposits of public non-financial corporations by 20% to $401 million, other financial corporations by 25% to $403 million, and state and local government by 13% to $38 million. Also contributing to this was the growth from other nonfinancial corporations denominated in foreign currency by 17% to $146 million. Meanwhile, other nonfinancial corporation transferable deposits in national currency recorded a marginal fall of 1% to $1,347 million and other resident sectors (household and individuals) remained the same at $466 million this quarter. Year-on-year saw M1 grew by 18% against the same period in 2015.

Broad Money

Broad money supply (M3) grew by 5% to $4,432 million this quarter, following a 1% rise in the previous quarter. The increase was mirrored in M1 combined with other deposits (saving and time), which marginally rise by 1% to $932 million (see Figure 4.2). Year-on- year growth saw M3 increased by 16% against the same period in 2015.

Figure 4.2: Components of M3

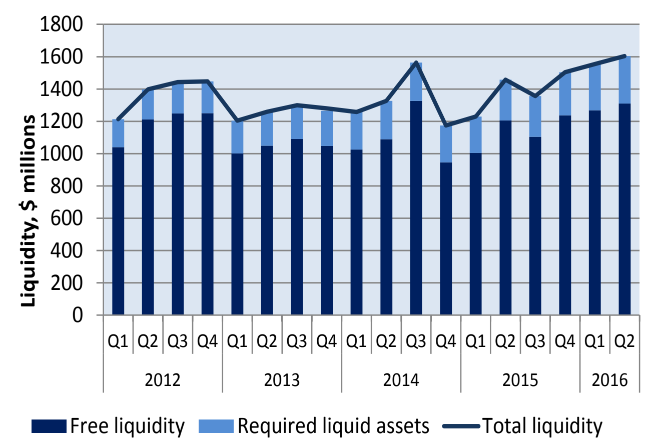


Contributing to the rise in M3 was the increase in NFA held by DCs and together with the NDA. NFA held by DCs grew by 1% to $4,189 million arising from higher growth in other foreign reserves along with fall in foreign liabilities. The widening of the NDA of the banking system, which went up to $269 million this quarter from $86 million in the previous quarter also contributed to the outcome. This was reflected by an increase in the private sector credit of the banking system despite a decrease in the central government's deposit held with the DCs.

Liquidity

Total liquidity in the banking system continued to increase this quarter by 2% to $1,603 million, following a 4% rise in the previous quarter. The increase was due to expansion in M0, resulting in excess liquidity rising by 2% to $1,156 million, following a 0.4 % rise in the preceding quarter. The growth in total liquidity was driven by increase in currency in circulation issued to ODCs in call accounts of commercial banks together with the draw-down in government deposits held at CBSI that moved from net liabilities of $1,213 million in the previous quarter to net liabilities of $1,093 million this quarter. Year-on-year comparisons saw total liquidity rose by 10% against the same period in 2015.

Figure 4.3: Commercial Bank's Liquidity



Source: CBSI

Domestic Credit

Total net domestic credit (NDC) of the banking system increased significantly by 25% to $810 million this quarter compared to 2% fall in the previous quarter. Driving this increase was a rise in private sector credit (PSC) of DCs by 1% to $2,070 million combined with the fall in liabilities to Central Government by 10% to $1,310 million at the end of quarter. The fall in government liabilities implied drawdowns in government deposits held with CBSI, which resulted in the net position of Central Government of DCs declining by 10% to $1,287 million this June quarter 2016.

Meanwhile, ODC's PSC marginally grew by 1% to $2,062 million following a 3% rise in the previous quarter. The growth in ODC's PSC was driven mainly by credit allotted to individuals by 6% to $711 million. Credit issued to other non-financial corporations, on the other hand decreased by 1% to $1,351 million compared to a 5% rise in the previous quarter.

By end of this quarter, total sectoral credit issued by ODCs reached $2,039 million, a $20 million increase from the previous quarter. The largest recipients of credit were personal, construction, distribution and communications, accounting for 33%, 14%, 13% and 9% respectively.

The key sectors contributing to growth this quarter were personal which moved from $667 million to $671 million, construction which grew from $259 million to $281 million, distribution up to $271 million from $260 million and tourism which went up to $129 million from $122 million (see Table5.1).

Table 5.1 Private Sector Credit by Sectors

SBD$million	2015		2016		Percentage Change		
	Q3-15	Q4-15	Q1-16	Q2-16	Q4-15	Q1-16	Q2-16
	A	B	C	D	B/A	C/B	D/C
Personal	622	709	667	671	14%	-6%	1%
Construction	189	186	259	281	-2%	39%	9%
Distribution	246	243	260	271	-1%	7%	4%
Communications	203	208	189	175	2%	-9%	-8%
Tourism	116	120	122	129	35	2%	6%
Prof. & Other Serv.	127	118	121	120	-7%	3%	-1%
Transport	111	114	117	120	3%	3%	3%
Manufacturing	120	130	136	124	9%	4%	-9%
Forestry	62	51	65	68	-18%	28%	5%
Agriculture	34	35	35	34	3%	0%	-3%
Entert.& Catering	4	3	3	2	-22%	-3%	-40%
Bills Receivables	0	0	0	0	0%	0%	100%
Mining & Quarrying	1	2	2	2	29%	-5%	10%
Fisheries	6	6	6	6	-4%	0%	0%
Statutory Corporn.	39	35	37	36	-105%	5%	-2%
Total	1,881	1,959	2,019	2,039			

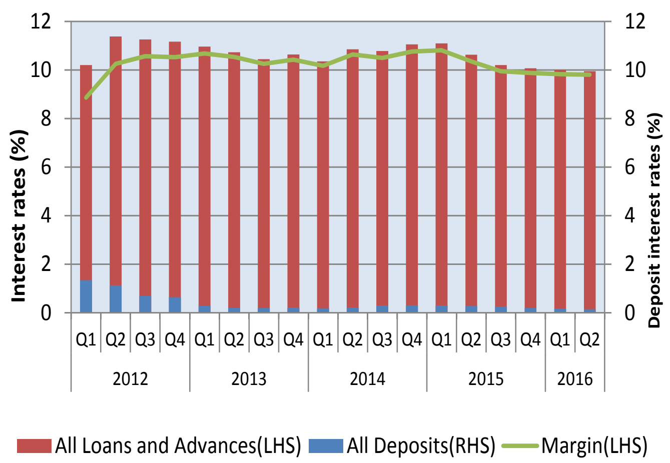
Note: Figure includes only the Commercial Banks and Credit Corporation of Solomon Islands. Excluding credit unions and accrued interest on loans and advances

The credit growth comprised mainly of increases in loans category, which grew by 2% to 1,820 million from $1,783 million in the previous quarter. Meanwhile, both overdrafts and lease financing fell this quarter by 7% to $204 million and 0.1% to $16 million respectively compared to the rise in both categories in the previous quarter.

Interest Rates

The ODC's indicative weighted average interest rate margin stood at 9.8% in June 2016, same as in the previous quarter. This was attributed to the unchanged movement in lending rates and a fall in the deposit rates. The indicative weighted average interest rate on lending remained unchanged at 10% at the end of the second quarter. This was due to cost of borrowing in some sectors remained stable such as forestry (19%), agriculture (10%), professional and other services (9.6%), distribution (9.5%), manufacturing (8.6%), tourism (8.1%), and statutory corporations (6.9%). However, the indicative weighted average interest rates on all deposits offered by ODCs continued trending downwards to 0.14% this quarter from 0.17% in the previous quarter. This came from drops in time deposits rates for maturity periods for up to 1 months, 3 to 6 months, 6 months to 1 year, and 2 to 3 years.

Figure 4.4: Commercial Banks' Interest Rates



Source: CBSI

Other Financial Corporations

The NFA of other financial corporations (OFCs) recorded a marginal growth of 1% to $255 million at the end of June 2016. This was driven by a rise in the foreign assets of the OFCs by 2% to $283 million despite an increase in total foreign liabilities by 20% to $28 million.

Meanwhile, the OFCs' NDA grew by 9% to $2,368 million this period, following a marginal growth of 2% in the previous quarter. Contributing to this was a 3% rise to $2,485 million in OFCs' net domestic credit, resulting from a rise in net credit to financial corporation mainly from transferable deposits held with ODCs and currency holdings. Meanwhile, net credit to nonfinancial public sector remains stable at $123 million.

Net credit to financial corporations picked up by 11% to $944 million, following a 4% rise witnessed in the March quarter. This was driven by increases in both the net credit to ODCs and CBSI by 11% to $925 million and 12% to $19 million, respectively. The rise in net credit to ODCs reflected a build-up of transferrable and other deposits of OFCs with ODCs, by 26% to $401 million and 1% to $526 million, respectively.

Private sector credit provided by the OFCs marginally fell by 1% $1,418 million, with year-on-year comparisons showed a fall of 3% against the same period last year. This stemmed from a fall in credits associated with Loans to other non-financial corporations by 2% to $94 million and settlements accounts of other nonfinancial corporations by 39% to $12 million. Trade credit by OFCs to private companies also decreased by 4% to $7 million. Meanwhile, the credit associated with shares to other nonfinancial corporations remains stable at $1,242 million at the end of June 2016.

Monetary Policy

The Central Bank continued to monitor recent inflation trends as part of its domestic price stability objective. At the end of June 2016, headline inflation stood at 2.9% down from 3.9% in the first quarter, driven mainly by domestic inflation components, which is considered temporary. This increase remained below the CBSI forecasted range of 3% - 5% in 2016. However, with excess liquidity recorded an increase this period, it wasn't considered as a source of inflationary pressure.

Of these recent economic developments together with the anticipation that prices will continue to be low at the end of 2016, the Bank therefore maintains its accommodative monetary policy stance this quarter by maintaining its monetary policy instrument. The cash reserve requirement ratio will still be maintained at 7.5% of the ODCs' total deposits liabilities over the period. However, the Central Bank plans to gradually raise Bokolo bills volume in the second quarter to absorb more excess liquidity.

In addition, CBSI continued to maintain its current exchange rate regime by pegging the Solomon Islands dollar against the currency basket to lessen exchange rate volatility. By end of the second quarter, gross foreign reserves of $4,223 million were sufficient to cover 10.3 months of imports compared to 10.2 months in the previous quarter. Despite the slight increase in import cover, it is comfortably above the three months benchmark.

The volume of the Government treasury bills CBSI administered remained capped at $40 million this quarter, same as in the previous quarter. Meanwhile, the weighted average yields (WAYs) for 56 days, 91 days bills remained unchanged at 0.34% and 0.46% from the last quarter. The WAYs for 182 days bill declined from 1.15% in the last quarter to 1.12% this quarter.

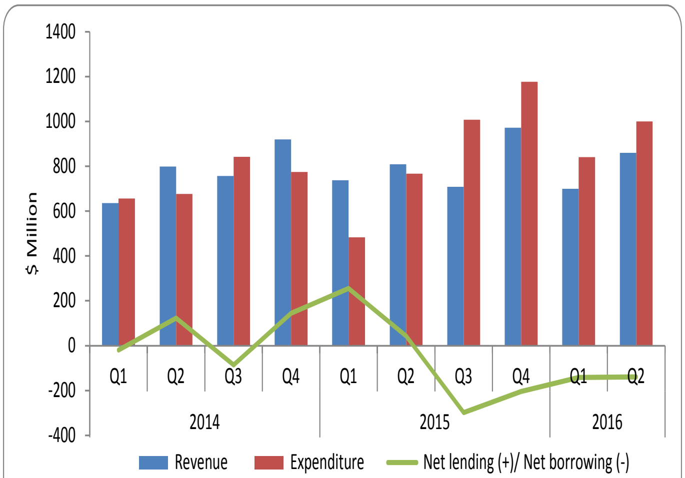
Chapter V. GOVERNMENT FINANCE

Overview

The Central Government registered a higher deficit of $147 million this quarter than the $72 million deficit in the quarter prior. The faster increase in total government expenditure relative to the surge in total revenue underscored the quarter-on-quarter unfavorable outcome. Meanwhile, as at end-June 2016, the Central Government's outstanding debt stock stood at $669 million, equivalent to 8% of nominal GDP.

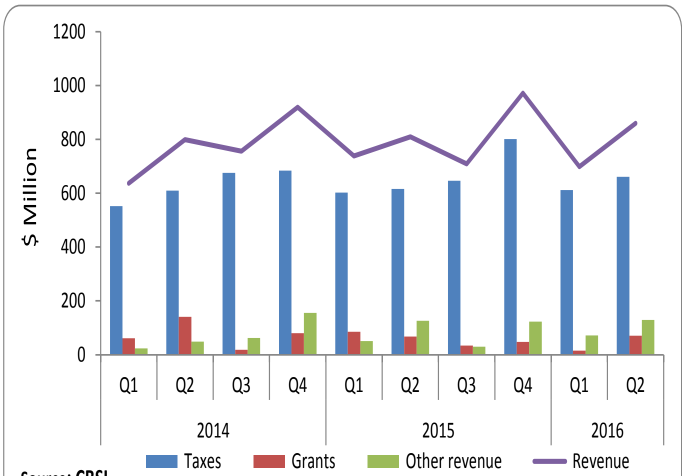
$281 million compared to the previous quarter and outperformed the budget by 5%. Compared to the preceding quarter, this outcome was attributed to a 25% increase in import duty to $135 million and a 33% upturn in export duties to $147 million. Import duty benefited largely from an 18% rise in goods tax to $82 million and a 12% increase in various import duty categories to $52 million. The latter was boosted by a 4% increase in log duties to $146 million sustained by revenues from higher value and volume of log exports.

Figure 5.1: Fiscal Balance



Source: CBSI

Figure 5.2: Fiscal Revenue



Source: CBSI

Revenue

Subsequent to a fairly lower outturn in the March quarter, total revenue rebounded with a 24% quarter-on-quarter increase to $869 million driven by increases in all major tax categories. This outturn was 7% higher compared to the corresponding quarter of 2015 but was lower by 1% against the budget. Proportionally, tax revenue remained the largest contributor to overall revenue with 76%, followed by nontax revenue with 16% and budget support with 8%.

Tax Revenue

Tax receipts increased by 8% against the preceding quarter to $661 million and up 7% compared to the same quarter a year prior. This increase was pronounced in all major tax categories namely; tax on international trade and transactions, income, profit and capital gain tax, and goods and services tax. However, this was a 4% shortfall against the budget.

Tax on international trade and transactions, which comprised 43% of tax revenue, increased by 9% to

Tax on income, profit and capital gains, which accounted for 36% of tax receipts, went up by 7% against March quarter to $236 million and up 17% against the same period in 2015 but was 1% less than the budget. Underlying the quarter-on-quarter outcome was a 17% upsurge to $136 million in tax payable by corporations. This increase stemmed from higher company provisional taxes, owing to payment of the June quarter tax dues, and dividend withholding taxes. In contrast, tax payable by individuals declined by 4% to $100 million on the back of reductions in private sector pay as you earn (PAYE) which negated gains in government sector PAYE.

Goods and services tax contributed 21% to tax revenue, slightly lower than the 23% contribution in the first quarter. Collections this quarter improved by 7% to $135 million albeit 3% down on the same period last year and 20% below budget. Against the preceding quarter, this outcome reflected a 27% increase in general tax to $104 million driven by increases in sales tax and goods tax. On the downside, excise tax fell by 34% to $26 million following reductions in beer and spirit export duties which eclipsed gains in tobacco export duties.

Property tax, which accounted for less than 2% of total tax collection, increased slightly from $6 million in the previous quarter to $8 million on the back of increases in Government lease on property withholding taxes.

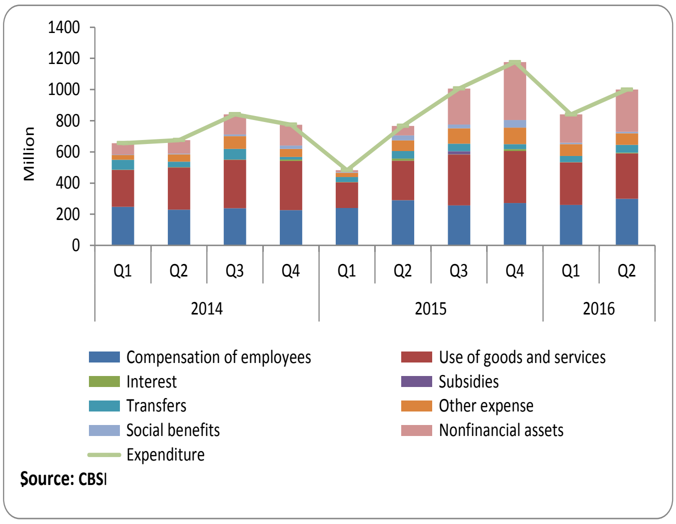
Non Tax Revenue

Nontax revenue jumped to $137 million this quarter from $72 million in the prior quarter. This outcome almost doubled the budget and 10% higher than the corresponding quarter of 2015. Driving this quarter-on-quarter growth was a 60% increase to $85 million in property income, mainly rental income from fishing license fees. Sales of goods and services also more than doubled the amount in the preceding quarter to $44 million, supported by higher administrative fee collections.

Grants

Total budget support increased more than threefold against the March quarter to $70 million and was 5% higher than the same period in 2015. However, this was still 39% below budget. By ministry allocation, Ministry of Education and Human Resource Development (MEHRD) received $42 million, Health and Medical Services (MHMS) $24 million, Ministry of Finance and Treasury (MoFT) around $3 million, and Ministry of Police and National Security (MPNS) $1 million.

Figure 5.3: Fiscal Expenditure



Expenditure

Total Central Government expenditure grew by 32% to $1,016 million, both against the previous quarter and the same period in 2015 albeit fell short by 10% against the quarterly budget. This outturn mirrored increases in both recurrent expense and development spending against the preceding quarter.

Compensation of Employees

Compensation of employees, which constituted 30% of total expenditure, rebounded this quarter by 16% to $300 million, after posting a 5% fall in the last quarter. This outcome was 8% and 3% higher than the budget and similar quarter of 2015 respectively. The growth against the previous quarter reflected a 15% upsurge in spending on wages and salaries to $283 million together with a 30% increase to $17 million in Solomon Islands Government contribution to Solomon Islands National Provident Fund (SINPF).

The major categories of compensation of employees registered increases during the quarter. The notable ones being public service salaries which rose by 31% to $173 million, various allowance by 32% to $31 million, special duty allowance almost doubled the previous quarter's spending to $14 million and SINPF member contributions which surged by 30% to $17 million. By ministry, MEHRD spending made up the largest share sitting at 44% ($119 million), trailed by MHMS with 21% ($57 million), MPNS with 9% ($24 million) and Prime Minister's Office (PMO) with 4% ($10 million). The rest spent less than $10 million each.

Purchase of Goods and Services

Consumption spending in the three months to June made up 29% of the total government outlays following a 6% increase to $291 million. Against the corresponding quarter last year, this was 15% higher but 34% down against the budget. Increases in consultancy fees, electricity, maintenance of roads and bridges, telephone and faxes, and conferences and seminars underscored the higher outturn in purchase of goods and services.

All major consumption spending increased this quarter except for training costs which declined by 3% to $56 million. Consultancy fees more than doubled to $26 million, utilities went up to $32 million from $20 million, maintenance of roads and bridges jumped to $20 million from less than a million whilst conference and seminars went up to $12 million from $8 million in the last quarter. MEHRD's spending remained the largest portion of other charges spending this quarter with around 23% ($67 million) despite being 45% lower than in prior quarter. This was followed by MID at $42 million (14%), both the PMO and MPNS followed with (10%) $28 million each and Ministry of Health and Medical Services with 8% $24 million whilst all other line ministries spent below $18 million.

Grants

Grants extended to other general government sectors, which accounted for 6% of the total expenditure surged by 34% in June to $56 million. This outcome surpassed both the budget and same quarter last year by 15%. The overall increase over the preceding quarter was driven by transfers of $11 million to Solomon Islands National University (SINU) which was not paid in the last quarter. Fixed service grant also rose by 33% to $20 million; subvention grants to Solomon Island Visitors Bureau (SIVB) went up to $5 million from $3 million and health grants up by 10% to $18 million. Provincial grants, on the other hand, shrunk to $2 million from $7 million in March quarter.

Social Benefits

Social benefits, the least contributors to total expenditure, rose by 6% to $10 million but were 20% and 68% respectively below budget and the same period of 2015. The marginal increase compared to March quarter was related to payment of long service benefit to retired officers which surged to $5 million from $4 million and pensions and gratuities under agreement which remained broadly unchanged at $3 million and $1 million respectively. Workers compensations, in contrast, slipped from $1 million in the previous quarter to less than half a million.

Other payments

Other expenses fell by 3% in the second quarter of 2016 to $74 million. Compared to budget, this was 26% lower but 7% more than the corresponding quarter of 2015. The fall against the quarter earlier was associated with basic education grants dropping from $24 million to less than a million and Members of Parliament (MPs) scholarship award grants falling from $12 million to $1 million. In contrast, subvention grants increased to $37 million from $21 million, Community Sector Obligation (CSO) to $11 million from $4 million and church grants to $10 million from $4 million. Meanwhile, government spent less than $3 million each on other items in the group.

Acquisition of Nonfinancial Assets

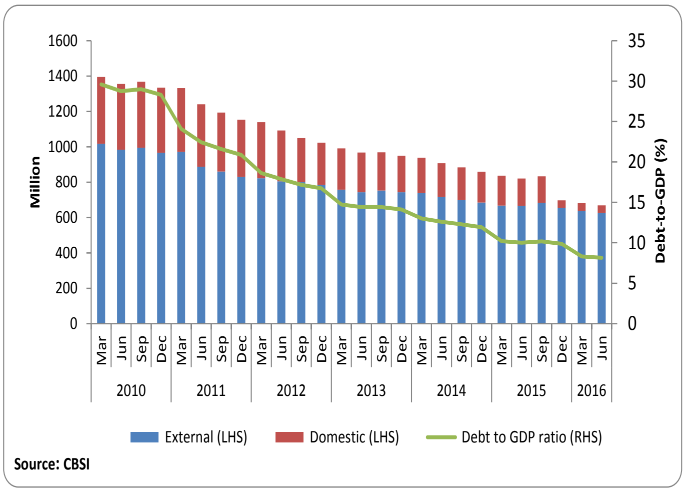
Consistent with the quarterly trend, acquisition of non-financial assets more than doubled the first quarter spending to $281 million. This level of spending exceeded the budget by 19% and more than tripled spending recorded in the similar quarter of 2015. The marked increase over the prior quarter was attributed to almost threefold increase in acquisition of fixed asset to $278 million combined with the increase in non-produced assets to $3 million from less than a million in the last quarter.

All NFA major components featured increased during the quarter. Spending on other machineries and equipment, which accounted for 23% of the total NFA, rose to $61 million from $8 million. Residential dwellings, at 20% of NFA, went up to $53 million from $28 million, acquisition of ships to certain constituencies made up 16% ($43 million) and spending on non-residential building, at 14%, went up by 68% to $37 million. The residual NFA components accounted for less than 10% of the total NFA outlays.

Central Government Debt Stock and Servicing

The Central Government's debt fell to $669 million this quarter from $681 million posted in the last quarter. Underlining the quarter-on-quarter fall was a 7% increase to $17 million in debt repayment to both external and domestic creditors. Meanwhile, total debt to NGDP ratio remained broadly unchanged at 8% as in the first quarter of 2016.

Figure 5.4: Central Government Debt Stock



External Debt Stock and Servicing

Central Government external debt waned by 2% in the second quarter to $625 million and was 6% lower than the corresponding quarter of 2015. Principal repayment of $14 million together with $3 million interest payment underscored the quarter-on-quarter fall in the external debt. External debt holdings by creditors, Asian Development Bank (ADB) accounted for 48%, followed by EXIM at 37%, European Union

(EU) at 8%, International Development Association (IDA) at 5% and International Fund for Agriculture Development (IFAD) accounted for the remainder. Meanwhile, total debt servicing this quarter exceeded the repayment schedule by 5% to $16 million.

Multilateral creditors retained the largest portion of external debt at 86%, having reduced from $544 million the quarter earlier to $535 million whilst bilateral creditors constituted 14% of external debt, following a 4% drop to $90 million against the prior quarter. In terms of currency composition, 81% of total external debt was in SDR, 16% in USD and 3% in Euro.

Domestic Debt Stock and Servicing

Domestic debt stock increased marginally by 2% this quarter to $44 million but dropped 72% against the similar quarter of 2015. The marginal increase came about following a one million increase in the auctioned Treasury bills during the quarter despite servicing of $0.1 million to domestic bidders. The remaining domestic debt comprised of $5 million in special securities and $39 million in government Treasury Bills.

Debt Sustainability Indicators

All liquidity indicators maintained the same level as in the last quarter. Debt-to-export of goods and services and debt service-to-domestic revenue remained at 2% each and debt service-to-domestic revenue at 0.2%.

Statistical Tables