Statement by CBSI Governor, Dr. Luke Forau at the launch of the 2021 CBSI Annual Report, on 6th July 2022

Salutations & Acknowledgements

1. Introduction

Fellow Solomon Islanders, friends, ladies and gentlemen, I am pleased to present the 2021 Annual Report of the Central Bank of Solomon Islands in this medium. The pandemic coupled with the November riot has made 2021 an incredibly challenging year for the country. The adverse impacts will continue to linger and take its toll on our economy. Even as we turned over the page, economic outlook for 2022 points to an even weaker prospects, with myriad of challenges in front of us, both from the external and domestic fronts.

The launch of this annual report gives me the opportunity to highlight key economic performance and outlook for the country, as well as account for the Bank's operations in 2021.

The theme for my statement today is *"**Navigating the way to recovery and strengthening resilience to mitigate future shocks**".* This theme is relevant to such shock-prone environment we are currently in, which underscores the need to be even more vigilant and resilient now than ever to the rising challenges and risks posed by the COVID-19 pandemic, climate and natural disaster risks, and now the impact of the Russian-Ukraine war.

Ladies and gentlemen, the current health of our economy is in a precarious situation. The state of our economy is likened to a person walking one step forward and two steps backward. From a bird's eye view, you will note that that person is in fact going backwards instead of going forward.

I will come back to this later, but first, let me provide you with a brief update on the economy's performance last year.

2. Solomon Islands Economy in 2021

The Solomon Islands economy was on its way for recovery in 2021, although at a slower pace, following the depressed condition in 2020. The onset of the riot in November however, quickly reversed the fragile recovery and pushed the economy back into recession, with a negative 0.6% growth at the end of 2021. The decline stemmed from declines across all sectors of the economy, with the exception of fish and copra.

The current account position worsened further, driven by the increase in imports relative to the slowdown in exports. The fall in primary income surplus during the year also contributed. Despite the worsening external position, gross foreign reserves for the country grew, reaching 14.2 months of import cover. This is well above the minimum target of six months. The increase in foreign reserves came mainly from donor funds and SIG revenue from fishing license.

In terms of government operations, the fiscal deficit position stood at 5% of GDP in 2021, owing to the adverse impacts of the COVID-19 pandemic and the November riot. The government debt stock increased to 15% of GDP by the end of the year, owing to COVID related borrowings.]

Labor market conditions remained subdued in 2021 in line with sluggish activities. Partial employment indicators from Solomon Islands National Provident Fund's (SINPF) showed a decline by 3% to 55,573 contributors in 2021 from 57,028 contributors in 2020. Public service positions declined by 38% both for filled and unfilled positions due to the on-going freeze in recruitment.

Consumer prices rallied to positive trajectory in 2021, following muted prices in 2020. Headline inflation reached 2.5% in December due to the surge in food and fuel prices in the second half of last year. Core inflation increased to 1.2% from -1.5% in 2020. The pick-up in core inflation indicated broad increases in the prices of broad items in the CPI basket during the year.

Recent headline inflation for April 2022 eased to minus 0.8% from minus 0.6% in March. Falling consumer prices in the domestic component of inflation contributed to this deflation. Domestic inflation fell to minus 4.2% from minus 3.2%, owing to price falls in betel-nut and tobacco. Imported inflation, however, rose to 8% from 6% in March attributable to high global fuel price as a result of the Russian-Ukraine war and its passthrough effects on transport, food and non-alcoholic beverages, housing, water and utilities categories. Core inflation increased to 3.3% from 2.8% reflecting broad price increases in April 2022.

3. Outlook

Now, let me turn to the outlook for this year and beyond.

Growth: The Solomon Islands economy was initially projected to decline by 7.3% in 2022, on the back of sluggish economic activity and on-going COVID-19 containment measures with declines expected across all sectors of the economy. This economic fallout was expected to bottom out over the medium term with some moderate rebound expected to start in 2024.

However, with containment measures now fully eased as of 1st July this year and international border restrictions lifted, the economy is now expected to recover earlier than anticipated. Under these conditions, GDP growth has been revised upwards and is expected to contract by 4.3% in 2022 (i.e. a 3-percentage points upward revision) and to rebound by 1.9% in 2023. This is better than expected six months ago. All sectors, except for logging, are expected to recover in 2023.

Risks to these forecasts however remain, and these include: (i) resurgence in COVID-19 cases that would lead to reinstatement of restrictions in economic activities; (ii) natural and man-made disasters, and the prolong Russian-Ukraine war. All these would reduce GDP.

Inflation: Following the surge in imported inflation in April 2022, inflation is expected to rise to around 3-4% by end of 2022, driven by surging global fuel prices due to the Russian-Ukraine war. Core Inflation is expected to rise to 4.7% on account of the pass-through effect of high fuel prices.

On the external front, the current account deficit is estimated to increase to 10% of GDP in 2022 and 13% of GDP over the medium term. This stems mainly from the re-opening of the economy and expected higher imports from construction activities of key national projects. This is expected to lead to a slight fall in reserves, however, expected strong donor support will keep reserves at comfortable levels over the near-term.

Fiscal: Fiscal pressures are expected to remain elevated in the near and over the medium term owing to weak revenue from declining logging activities while pressure on spending remains high. Consequently, the fiscal deficit is estimated to widen to 9% of GDP in 2022, leading to eroding of fiscal buffers and rapid increase in government borrowing.

Employment: Partial employment indicators (SINPF contributions and PAYE) showed partial signs of recovery from the pandemic in March 2022. While employment outlook is unavailable, it is expected that the labor market would move in line with economic activity over the near term.

4. CBSI Operations

Turning to the Central Bank's operations; the Bank reported a net loss of $62.7 million at the end of last year, stemming from weak investment returns overseas and unfavorable foreign currency revaluations.
Of the $62.7 million loss, $15.5 million was realized (operational) losses and $47 million was due to unrealized foreign currency revaluation. The Bank's net equity however, remained firm at $308 million.

Despite the loss, the Bank continued to operate and managed its resources prudently, thereby achieving its mandate. Moreover, the Central Bank managed to cushion the economy from worst adversities in the toughest of times.
This, of course, was done with the strategic oversight role played by the Board, which I commend them sincerely. With the full board comprising nine directors, they were able to provide strategic direction to the organization.

In terms of staffing, there was no change to the Bank's staff complement. The total number of staff complement remained unchanged at 157, as was in 2020. Of the 157 staff, 61% were male and 39% female. The Bank continues to invest in training and upskilling of its work force despite COVID-19 setbacks. A total of 20 officers were engaged in full and part-time trainings, of which 9 officers successfully completed their tertiary qualifications.

With respect to financial stability, the overall financial system remains stable and sound amidst weak economic conditions and COVID-19 induced disruptions in 2021. The Central Bank relaxed prudential guidelines 2 and 8 during the year to allow financial institutions to provide loan reliefs to borrowers. Furthermore, CBSI granted a full banking license to Solomon Finance Limited (SFL) in December 2021 to operate banking services as a credit institution.

In the financial inclusion space, the Bank and its stakeholders launched the third National Financial Inclusion Strategy for Solomon Islands (NFIS3) 2022-2025 in 2021. The strategy provides a roadmap of key strategic objectives of financial inclusion policies and activities for the next 3 years.

5.“Navigating the way to recovery and strengthening resilience for future shocks”

Let me now turn to the theme of my statement on **“Navigating the way to recovery and strengthening resilience for future shocks”**. Like the analogy of a ‘person walking one step forward and two steps backward’, Solomon Islands as a small open economy, will continue to face risks of further macroeconomic slowdowns, coming from both the external and domestic fronts.
Externally, the Russian-Ukraine war brings a new setback, on top of the pandemic, adding further threats to inflation and recovery for the country.

Domestically, COVID-19 new variant, declining fiscal space amid elevated debt levels, and spillover effects from the war among other things are adding to headwinds for the economy's recovery.

Nonetheless, these challenges bring opportunities for a relook at our macroeconomic policies, objectives, choices, technology and doing things differently. We need to get the economic fundamentals right, with the right policy mix to move this country forward and improve our living standard.

I would like to emphasize that these emerging challenges and opportunities will be the new normal that we will live with. Therefore, strengthening our capacities to navigate these uncertainties will be an important determinant for a resilient recovery from the pandemic.

Three key actions we can Prioritize now to start economic recovery include:

1. Expedite and maintain support for the affected businesses till the recovery takes hold. The return to economic activity and growth hinges on their ability to weather the pandemic and return to work safely and revive from the aftermath of the riot. Business activities have been severely disrupted since the pandemic started, with added challenges now on the horizon, in particular, war outside and the second wave, the future is more uncertain now than ever. It is encouraging to note that businesses and employees remained resilient last year despite these challenges and have successfully adapted to the new normal and returning to work quicker during the year. This brings me to my second point;

2. In the short to medium term, strengthening resilience and capacity across all sectors of the economy, to sustain the country's ability to absorb future shocks. Implement strategies that enhance revenue mobilization that will broaden the revenue base, build capital and macroeconomic buffers and expand and promote export diversification to foster a resilient economy. As an example, improving tax administrators' capacity, reducing tax evasion, improve tax compliance and increase efficient tax administration is a crucial objective to prioritize and execute.

3. Finally, as I had highlighted in my recent statement during my appearance before the Public Accounts Committee in March this year, we should start working on a growth policy that will drive growth in the country. Prioritizing key

commodities with export opportunities in non-logging sectors or new diversification opportunities for instance, can facilitate growth transformations for a resilient recovery.

6. Conclusion

In conclusion, small economies like ours will see much larger impacts of the pandemic, war, supply chain disruptions, rising global fuel and food prices and the greater uncertainty that lies ahead. Concerted responses to enhance our economic resilience will help us navigate these challenges successfully now and in the future.

Let us take advantage of the window of opportunities that come with these challenges to recover better and change our strategies by doing things differently, from a “business as usual” environment to delivering the changes needed to start recovery.

Finally, I would like to thank all our stakeholders; the government, various institutions, the private sector, development partners and individuals who provided data and information to this report and our work in 2021.

I would also like to thank our auditors - the Office of the Auditor General and the contracted external auditor, PricewaterhouseCoopers (PwC) of Fiji - for finalizing our accounts.

A special acknowledgement to the hardworking CBSI Board of Directors, the Management and the Staff for their dedication and commitment to achieving the objectives of the Bank in 2021 despite the challenges.

With these few comments, ladies and gentlemen, it is my pleasure to now launch the Central Bank of Solomon Islands’ 2021 Annual Report for your reading.

Thank you very much and May God Bless Solomon Islands.