MONETARY POLICY STATEMENT

September 2024

CENTRAL BANK OF SOLOMON ISLANDS

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Contents

List of Figures

List of Tables

1. Overview

Despite continued tests to its resilience, the global economy remained fairly nimble over the first half of 2024, with growth expected to reach 3.2%[1] by year's end on the back of an expansion in global trade. The global fight against inflation has proved largely successful, with many Central Banks now beginning to ease their monetary policy stances so as to rekindle growth, even at the cost of slower disinflation ahead. Commodity prices fell over the first semester of the year, albeit with substantial volatility, with food prices declining by 3% and energy prices by 8% in year-on-year (y-o-y) terms. The global outlook remains optimistic overall, with growth expected to rise further in 2025 even amidst lingering geopolitical uncertainty and enduring macroeconomic challenges.

On the domestic front, economic activity in Solomon Islands strengthened during the first semester of the year, on account of positive outturns in the fishing, forestry, manufacturing and construction sectors. Meanwhile, the services sector experienced a slowdown, partly reflecting base effects following the hosting of the Pacific Games (PGs) in Honiara in November and December 2023. Conditions in the formal labour market improved in line with the economic expansion, as revealed by a sizeable increase in the number of contributors to the Solomon Islands National Provident Fund (SINPF) during the period.

The country's headline inflation rate eased slightly to 3.4% in June from the 3.5% recorded in December 2023. This is reflective of stabilisation in world crude oil prices, which in turn facilitated a decline in imported inflation in Solomon Islands from 4.7% in December to 3.2% in June. On the other hand, domestic inflation rose from 3.1% to 3.6% over the same period, an outcome attributable to weather-driven supply-side disruptions in the country. Meanwhile, core inflation declined to 3.2% in June from 3.5% in December: in spite of continuing disinflation, it remains relatively elevated, reflecting persistency in price-setting and enduring inter-island logistical challenges.

On the other hand, monetary conditions in Solomon Islands eased over the first half of 2024, with most monetary indicators registering growth even as systemic liquidity edged down. In a potential sign of improving banking-sector efficiency, the average interest-rate margin between loans and deposits narrowed further in the first semester of the year to 7.77%.

Meanwhile, Solomon Islands' external position weakened slightly over the same period. The balance-of-payment (BOP) surplus narrowed relative to the prior semester, due to a sizeable reduction in the capital and financial accounts surplus which outweighed an improvement in the current account position. Gross foreign reserves declined in line with the reduction in the overall surplus.

Finally, fiscal conditions improved, with a narrowing of the deficit to $85 million from the substantial deficit posted in the prior semester. This resulted from a sizeable slowdown in fiscal expenditure, which likely reflected constraints on spending by the caretaker Government in the months leading up to the April National General Election (NGE), as well as the period of formation of the new Government thereafter. While rising in nominal terms, the stock of Government debt remained stable at 21% of GDP.

In light of such economic developments, the Solomon Islands' economy is projected to expand by 3% in 2024, marking an upward revision of 0.1 percentage points (pp) relative to the 2.9% forecast in the Monetary Policy Statement (MPS) for March 2024, and reflecting stronger growth in fishing, forestry, manufacturing and the public sector.

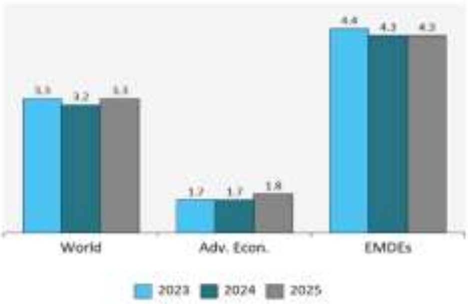
Overall risks to the domestic outlook remain balanced. On the upside, favourable fishing conditions are currently facilitated by the onset of the La Niña effect; higher export commodity prices, and greater-than-anticipated outturns in logging may spur production further. On the downside, inefficient inter-island shipping services, higher logistics costs and heavier rainfall also attributable to the La Niña effect may all cause supply-side disruptions and therefore weigh on economic activity.

[1] The International Monetary Fund (IMF) World Economic Outlook (WEO), July 2024 Update

2. International Economic Developments

The global economy remains resilient, supported by an expansion in trade and an overall increase in economic activity during the first half of the year. Growth is projected to reach 3.2%[2] in 2024, in line with earlier forecasts[3], and then edge up to 3.3% in 2025, on the back of a stronger performance in both Advanced Economies and Emerging Market and Developing Economies (EMDEs).

Figure 1: Global Economic Growth



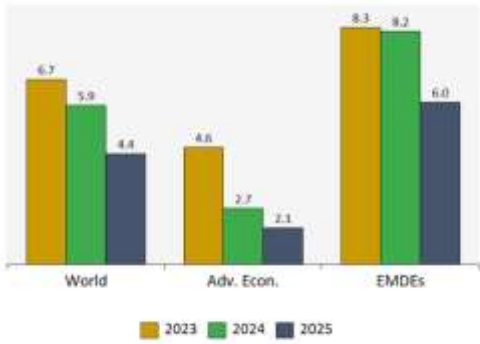
In particular, the rate of economic expansion in Advanced Economies is projected at 1.7% in 2024, with growth forecast to reach 0.9% in the Euro Area, due to improvements in the services sector and higher-than-expected net exports in the first half of the year, and 2.6% in the USA. The latter marks a 0.1 pp downward revision from the April 2024 WEO, in light of a slowdown in household consumption and underperformance in trade. Advanced Economies are then forecast to expand by 1.8% in 2025.

Meanwhile, growth in EMDEs is projected at 4.3% for both 2024 and 2025. The projection for the latter year enjoyed a 0.2 pp upward revision from the April 2024 WEO, reflecting improvements in the economic outlook in Asia, particularly in China and India. Growth in China, a key trading partner for Solomon Islands, is projected to reach 5.4% in 2024, on account of a rebound in private consumption and strong exports in the first quarter of the year, before easing to 5.1% in 2025 due to rising headwinds from an ageing population and slowing productivity growth.

Regionally, contractionary monetary policy contributed to a lacklustre performance in Australia in 2023, but growth is then projected to pick up to 1.7% in 2024 on the back of robust domestic demand[4]. In New Zealand, meanwhile, economic activity remains weak, a condition expected to persist into 2024 and partly underpinned by weaknesses in household consumption as well as residential and business investment.

On the inflation side, price-rise pressures are continuing to ease globally. World headline inflation, whilst still elevated, is forecast to reduce to 5.9% in 2024 from 6.7% in 2023, and to ease further to 4.4% in 2025 in a downward trend common across both Advanced Economies and EMDEs. In the former group, inflation is projected to decline from 4.6% in 2023 to 2.7% in 2024 and 2.1% in 2025, marking however a 0.1 pp upward revision from the April 2024 WEO forecast due to persistent services inflation and higher commodity prices. Meanwhile, in EMDEs, inflation is expected to remain elevated and fall more slowly than in Advanced Economies, having already largely reached pre-pandemic levels.

Figure 2: Global Inflation



Within the Pacific region, inflation in Australia, 3.8% as of June, remains above the 2-3% target set by the Reserve Bank of Australia (RBA), due to robust aggregate demand pressures and a tight labour market. It is nonetheless expected to return to target by year's end, potentially rebounding thereafter[5]. Meanwhile, inflation in New Zealand continues to decline, easing from the 6.7% recorded in 2023 to 4.0% in 2024, and it

[2] Unless otherwise indicated, all statistics in this section are obtained from IMF WEO, July 2024 Update.
[3] IMF WEO (April 2024).
[4] Reserve Bank of Australia, Statement on Monetary Policy (August 2024).
[5] Reserve Bank of Australia, Statement on Monetary Policy (August 2024).

is projected to fall further to 2.8% in 2025 on the back of restrictive monetary policy[6].

Within this inflationary context, commodity prices experienced significant volatility in the first half of 2024, with the International Monetary Fund (IMF)'s primary commodity price index rising by 7% against December 2023 to a peak of 170 points in April before slowing down to 167 points in June. This outcome reflects mixed movements in the non-energy, food and energy indices over the period. In particular, the energy index rose by 8% to 189 points in April, before easing to 186 points in June. It is then expected to decline by a further 4% by the end of the year. Meanwhile, the non-energy index rose by 4% to 154 points in June, and it is predicted to rise by a further 4% during the remainder of in 2024. In terms of key import commodities for Solomon Islands, rice prices remain elevated compared to historical levels, at US$632 per metric tonne at the end of June – 23% higher compared to the same period a year ago. Finally, and consistently with movements in the energy index, the price of Tapis crude, the main imported fuel for Solomon Islands, surged from US$84 per barrel in December 2023 to US$96 in April, before easing to US$85 in June.

Overall, risks to this outlook remain balanced, even though some near-term risks have gained prominence. These include downside risks emanating from slower progress on services disinflation, as well as potential upside price pressures resulting from rebounding trade and any further escalation in geopolitical tensions.

3. Domestic Economic Developments

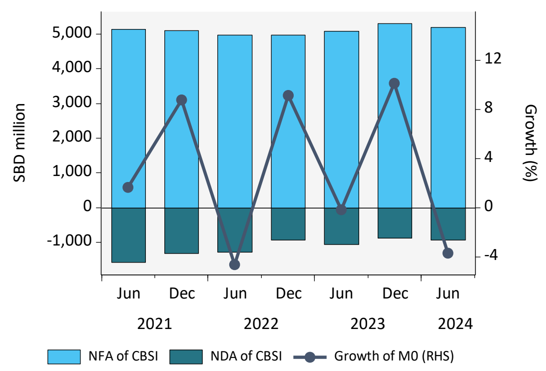
3.1. Monetary Conditions

The key monetary indicators displayed varied movements in the first half of 2024. Narrow money (M1), private sector credit (PSC) and broad money (M3) all firmed up, while reserve money (M0) and excess liquidity declined. The interest-rate margins offered by Other Depository Corporations (ODCs) also contracted during the first half of the year.

3.1.1. Reserve Money

M0 dipped by 4% to $4,274 million in the first half of 2024, partially undoing the 10% growth recorded during the second semester of 2023.

Figure 3: Drivers of Reserve Money (M0)



Source: CBSI

The fall was spurred by declines in both currency in circulation and call balances by ODCs', by 3% to $1,377 million and 2% to $2,892 million, respectively. The decline in reserve money mirrored a 2% fall in net foreign assets (NFA) to $5,200 million, offsetting a 7% increase in net domestic assets (NDA) to minus $917 million.

3.1.2. Money Supply

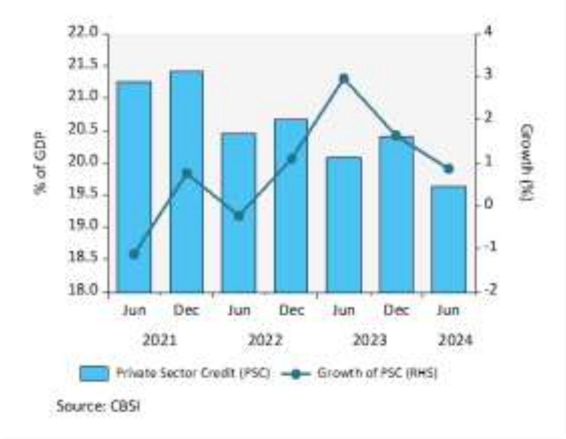
The money supply (M3) grew by a marginal 1% to $6,249 million in the first half of the year, building on an 8% increase during the latter semester of 2023. The growth in M3 reflects upticks in both M1 and other deposits, both rising by 1% each to $5,228 million and $1,021 million, respectively. On the sources' side, the growth was driven by both the NFA and NDA of the banking system: NFA expanded by 1% to $5,605 million, while NDA rose by 5% to $693 million during the period.

3.1.3. Credit Conditions

Total lending to the private sector grew by 1% to $2,787 million (19.6% of GDP) in the first half of the year, compared to $2,763 million (20.4% of GDP) in the prior semester. The increase in lending was primarily driven by ODC loans, which expanded by 1% to $2,763 million.

[6] Reserve Bank of New Zealand, Monetary Policy Statement (May 2024).

Figure 4: Credit to Private Sector

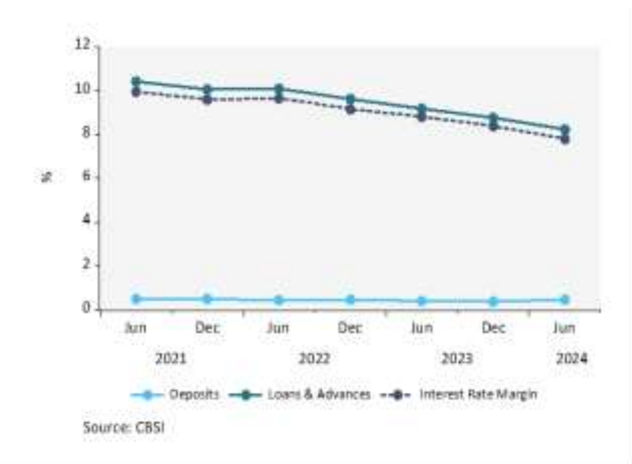


Key sectors explaining the expansion include personal loans for investment properties, construction (commercial buildings in particular), tourism and fisheries. In contrast, lending declined in the distribution, transport, manufacturing, forestry and communication sectors.

3.1.4. Interest Rates

The ODCs' interest-rate margin narrowed by a further 7% in the first half of 2024, down to 7.77% from the 8.36% recorded in the second semester of 2023. This decline was underpinned by a reduction in the indicative weighted average (IWA) rates for lending, from 8.74% to 8.23%, and an increase in the IWA rates for deposits, from 0.38% to 0.46%.

Figure 5: Interest Rates



The decline in lending rates stems from rate reductions in the personal loans, manufacturing, agriculture, fisheries, distribution and construction sectors; meanwhile, the rise in deposit rates is attributable to increasing rates on both interest-bearing demand deposits and other deposits (savings and time).

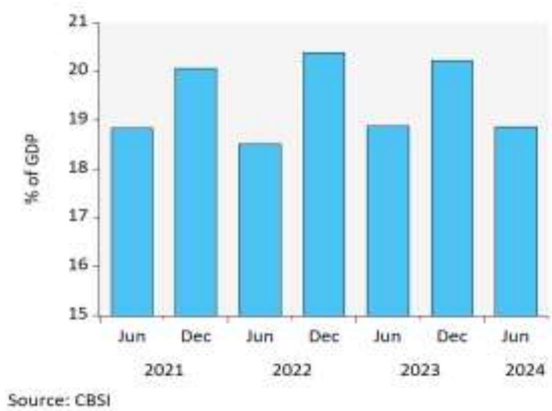
3.1.5. Open Market Operations

The weighted average interest rate (WAIR) for the CBSI's Bokolo Bills remained virtually unchanged at 0.24% throughout the first half of the year. The Bills' stock issuance remained capped at $430 million per month, with marginal undersubscription by participating banks leading to an average absorption of $371 million. Meanwhile, the stock of Treasury Bills issued reached $175 million in June 2024, up from $95 million in December 2023. The WAIR for the 91-, 182- and 365-day Bills all increased during the review period, from 0.50% to 1.12%, 2.39% to 2.40%, and 2.60% to 2.63%, respectively.

3.1.6. Liquidity Levels

Free liquidity in the banking system declined by 2% to $2,678 million (18.9% of GDP) in the first half of 2024, down from $2,738 million (20.2% of GDP) in the latter half of 2023. The fall reflected a drop in the Central Bank's NFA, driven by lower capital donor inflows during the six months to June.

Figure 6: Liquidity



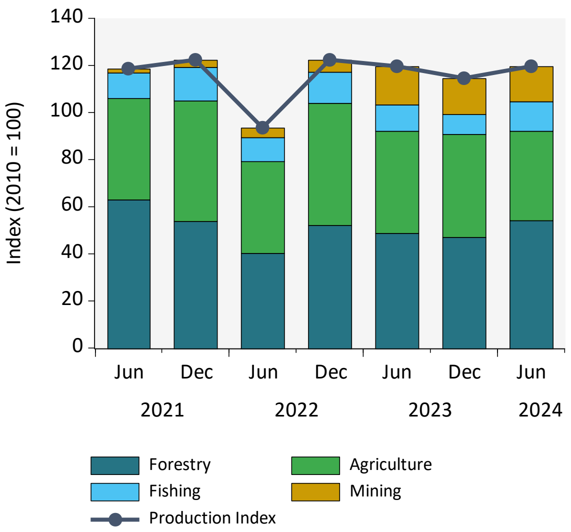
3.2. Domestic Conditions

Domestic economic activity showed signs of growth in the first semester of 2024, thanks primarily to stronger-than-expected outturns in the fishing, forestry, manufacturing and construction sectors. Gains in these industries outperformed weaker production in agriculture, mining, tourism, communications and the public sector. The slowdown in the services sector in particular had been anticipated, due to the climate of political uncertainty that characterised the lead-up to the 2024 NGE in April. Furthermore, businesses in Honiara were negatively impacted by traffic congestion caused by poor road conditions and ongoing road upgrades in both East and West Honiara. Nonetheless, results from the Business Perception Survey reveal growing business confidence, and an expected improvement in business conditions.

3.2.1. Production Index

The CBSI's production index increased in the first half of 2024 by 5 points to an index value of 120. This positive outcome stemmed from higher output in the forestry and fishing sectors, which recorded a 7-point and a 4-point increase, respectively, while the agriculture sector yielded a 6-point decline, due to a fall in copra and cocoa production that outweighed higher palm oil and coconut oil output. In y-o-y terms, the production index recorded a modest pickup of 0.1%, reflecting mixed outcomes in the primary sector in latter semester of 2024.

Figure 7: Production Index

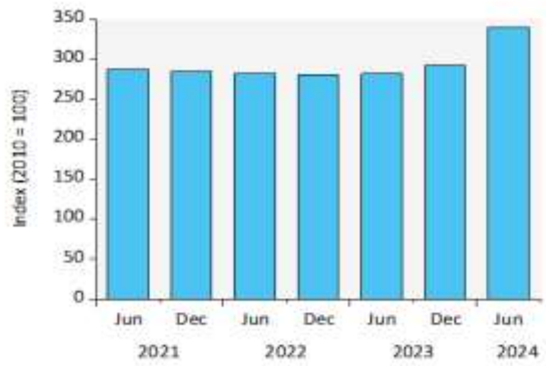


Source: CBSI

3.2.2. Manufacturing

In contrast, the manufacturing index surged by 47 points to an index value of 339 during the first semester of 2024. This significant increase was spurred by a 24% expansion in the manufacture of goods for export, mainly canned tuna and fish loins, facilitated by a higher fish catch as well as favourable global prices and demand during the period.

Figure 8: Manufacturing Index



Source: CBSI

3.2.3. Other Sectors

Indicators of activity in other sectors displayed signs of slowdown in the first semester of 2024, most likely attributable to base effects following the positive shock of hosting of the PGs in Honiara in the latter months of 2023. For instance, provisional figures for visitor arrivals reveal that a total of 9,855 visitors entered Solomon Islands in the six months to June 2024 – a significant decline across all categories from the exceptional 17,041 arrivals recorded in the preceding semester.

Cement imports, which are a proxy for investment, also declined significantly, suggesting a slowdown following the completion of major sports facilities ahead of the PGs in 2023. However, the ongoing construction of several donor-funded infrastructure projects in Honiara and across the Provinces has contributed to a climate of overall resilience in the construction sector over the first half of the year.

Next, the Communication Index, which gauges the performance of the country's communications sector, is estimated to have declined by 8 points to an index value of 740 in the semester to June 2024. Both mobile and internet usage declined during the period, contracting by 2 and 13 points, respectively.

Finally, the Business Perception Survey conducted by CBSI in July 2024 showed that both business conditions and firms' economic performance over the first half of 2024 improved, albeit marginally. Most businesses reported having been negatively affected by rising prices, traffic congestion and an overall climate of political uncertainty in the months leading up to the 2024 NGE and into the period of formation of the new Government; nevertheless, due to prospects of easing inflation and favourable conditions over the next few months, they also reported optimism and expectations of revenue gains alongside an uptick in profitability. Overall, the firms' perception of the overall economy remains positive, indicating growing business confidence.

3.2.4. Employment

Conditions in the labour market improved over the first semester of 2024. The total number of active and slow-active contributors to the SINPF, a partial indicator for employment conditions, rose by 5% to 59,854 contributors. This positive outcome is reflective of an expansion in personnel in public administration and defence as well as in the wholesale and retail, mining and quarrying, forestry, and manufacturing sectors. In contrast, the number of job vacancies advertised declined during the period.

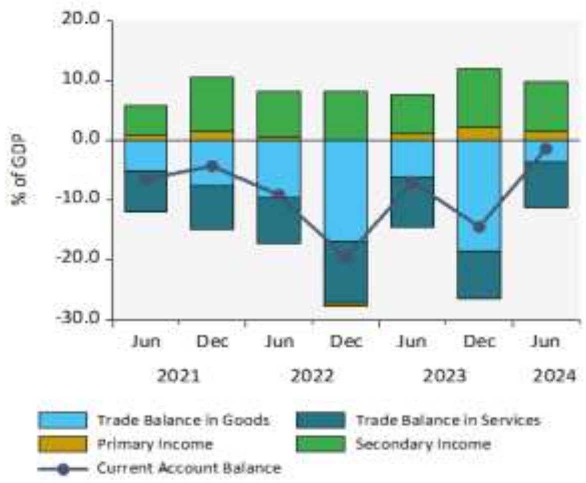
3.3. External Conditions

Solomon Islands' BOP position surplus contracted to $21 million (0.3% of GDP) in the first half of 2024 from a revised $92 million surplus (1.4% of GDP) in the latter semester of 2023. This outcome stemmed from a sizeable reduction in the capital and financial accounts surplus, which outweighed even a substantial reduction in the current account deficit over the same period. As a result, gross foreign reserves declined by 3% to $5,613 million over the period, reversing the 3% growth recorded during the second semester of 2023.

3.3.1. Current Account

The current account balance deficit narrowed to $105 million in the first half of 2024, down from the $983 million recorded in the preceding six months. This is primarily attributable to an improvement in the trade balance in goods, which narrowed to minus $262 million at the end of June 2024 from minus $1,248 million during the second semester of 2023. This in turn was prompted by higher exports in the forestry, agriculture and mining sectors, owing to favourable export prices and demand, while imports fell by 19% following declines across all major import categories.

Figure 9: Trade and Current Account



Source: CBSI

Meanwhile, the deficit in the trade in services remained virtually unchanged at $542 million, as higher Government payments on goods and services offset a pick-up in receipts for stevedoring and other port services. At the same time, the secondary income surplus reduced to $592 million due to a fall in donor grants, while a 21% contraction in the primary income surplus to $107 million may be attributed primarily to high dividend payments.

3.3.2. Capital and Financial Accounts

At the same time, Solomon Islands' capital and financial account surplus declined substantially to $163 million from the $1,261 million posted in the semester to December 2023. This outcome reflects lower donor capital grants as well as higher outflows in the financial account due to an increase in currency and deposits held by depository institutions abroad.

3.3.3. Foreign Reserves

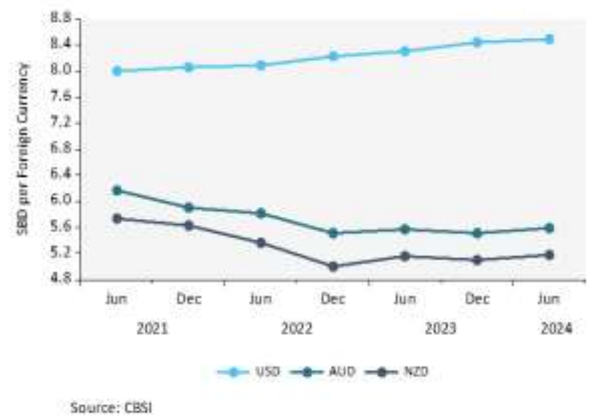
As a result of the fall in the capital and financial account surplus, the country's gross foreign reserves fell by 3% to $5,613 million (US$663 million) in June 2024. This level of reserves is nonetheless sufficient to meet 10.4 months of imports of goods and services.

Figure 10: Gross Foreign Reserves

3.3.4. Exchange Rates

Global currency movements, particularly the weakening of the US dollar (USD), led to a 0.7% appreciation of the Solomon Islands dollar (SBD) against the Trade Weighted basket to 114.8 points. In terms of the bilateral trading currencies, the SBD depreciated against the USD by 0.6%, to $8.49 per USD, and against both the Australian dollar (AUD) and the New Zealand dollar (NZD) by 1.5%, to $5.59 per AUD and $5.18 per NZD, respectively.

Figure 11: Nominal Bilateral Exchange Rates

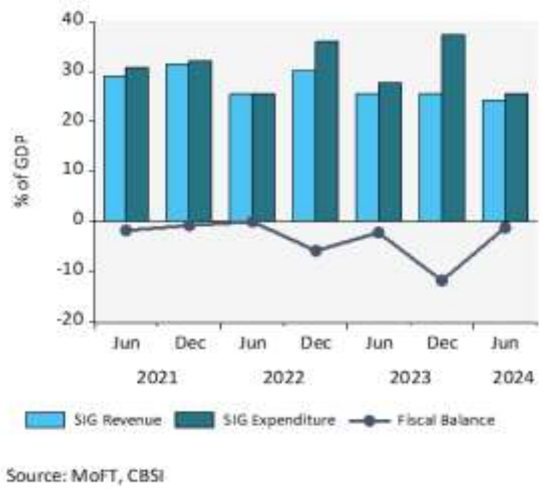


Finally, the country's Nominal Effective Exchange Rate (NEER) depreciated by 0.3% to an index value of 121.5, while the Real Effective Exchange Rate appreciated by 2.2% to 140.4 during the period, reflecting inflation differentials between Solomon Islands and its trading partners and implying a slight loss of trade competitiveness.

3.4. Fiscal Conditions

Fiscal conditions improved during the first half of 2024, with a narrowing of the deficit to $85 million (1.2% of semi-annual GDP) from the $797 million (11.8% of semi-annual GDP) recorded during the prior six months.

Figure 12: Fiscal Balance

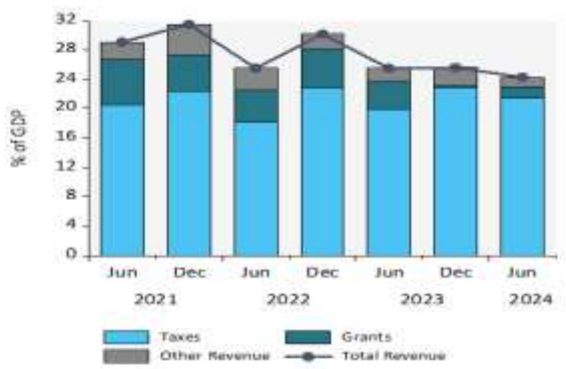


This outcome was driven by a sizeable reduction in Government spending, attributable to limitations on the caretaker Government's ability to spend on new projects in the run-up to the NGE in April 2024, and to the period of formation of the new Government thereafter. Such a reduction in spending outweighed a marginal decline in total revenue. Nonetheless, the Central Government's debt stock continued to trend upwards during the period, following the disbursement of external loans and the issuance of domestic securities to overcome budget constraints and finance infrastructure spending.

3.4.1. Revenue

Total Government revenue slid by 0.4% in the first half of 2024 to $1,725 million (24% of semi-annual GDP), exceeding the bi-annual pro-rata budget expectations by 4%. The climate of political uncertainty surrounding the country's NGE might have been a contributing factor, with both tax and non-tax revenue declining relative to the prior semester. Meanwhile, donor grants revenue picked up during the period.

Figure 13: Government Revenue



Source: MoFT, CBSI

More specifically, tax revenue weakened marginally in the first half of the year, declining by 1% to $1,528 million – a value nonetheless 13% higher than the pro-rata budget. The overall decrease was largely driven by a fall in revenue from taxes on goods and services, while tax on income and international trade both picked up slightly during the period. In particular, inflows from taxes on goods and services contracted by 5% to $620 million, on account of lower revenue in goods tax, excise tax and stamp duty. Meanwhile, income tax revenue inched up by 0.3% to $571 million, reflecting upturns in company tax and Pay As You Earn (PAYE) revenue outweighing a fall in withholding tax, and revenue from taxes on international trade rose by 3% to $337 million, owing to a robust export performance, primarily of round logs.

Finally, donor grants surged to $102 million in the six months to June from the $19 million recorded in the prior semester, whereas a sharp decline in fees from fishing licences led to non-tax revenue shrinking by 43% to $95 million from the $167 million recorded in the six months to December 2023.

3.4.2. Expenditure

While Government revenue contracted only marginally in the first half of the year, expenditure declined more markedly, stopping at $1,810 million. This marks a 28% reduction relative to the previous semester, and a 4% decline y-o-y. The bi-annual budget was however exceeded by 7%.

The moderation in overall expenditure was recorded across both the recurrent and capital categories. The former returned to trend level in the first six months of 2024 thanks to a 19% decline to $1,615 million from the peak recorded in the second semester of 2023. This was the result of broad-based reductions in all categories, with purchase of goods and services shrinking by 36% to $525 million, compensation of employees (COE) contracting by 8% to $839 million and benefits and grants declining by 4% to $219 million, respectively.

Figure 14: Government Expenditure

Source: MoFT, CBSI

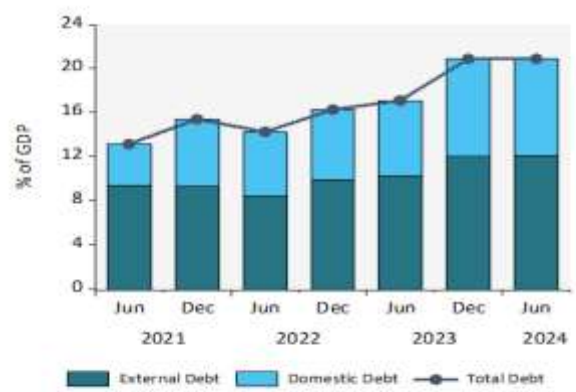
Capital-related expenditure, too, slowed to $195 million in the six months to June from the $545 million recorded during the prior six months. This was 1% lower than anticipated in the half-yearly pro-rata budget and 16% lower than the first six months of 2023, respectively. Such an outcome had been expected, due to constraints on spending by the caretaker Government in the months leading up to the April NGE.

3.4.3. Central Government Debt Stock

Meanwhile, the total stock of Central Government debt continued to increase during the first half of 2024, expanding by 5% to $2,965 million. Due to forecast economic growth in 2024, the debt-to-GDP ratio is expected to remain unchanged at 21% of GDP.

In nominal terms, both the external and the domestic debt stocks rose during this period. The former grew by 5% to $1,718 million (12% of GDP) following the disbursement of additional loans by the Asian Development Bank (ADB) and the International Development Association (IDA, part of the World Bank Group) for the construction of infrastructure-related projects, such as roads, sewages and new telecommunication towers in the Provinces.

Figure 15: Government Debt



Source: MoFT, CBSI

The total domestic debt stock also increased by 5% to $1,247 million, due to an expansion in the scale of domestic securities operations.

4. Domestic Economic Outlook

4.1. Real Economy Outlook

Growth in the Solomon Islands' economy is projected at 3.0% in 2024, following an upward revision of 0.1 pp against preliminary projections in March. This is the result of stronger-than-expected growth in fishing, forestry, manufacturing and the public sector, combined with expectations for moderate contributions from mining and construction. Risks to this outlook are broadly balanced. Favourable fishing conditions and export commodity prices, as well as higher-than-anticipated logging outturns, may spur production further; however, inefficient inter-island shipping services, higher logistics costs and adverse weather patterns could weigh on economic activity. Overall, in spite of the upward revision, growth remains fragile, and it is barely sufficient to meet current rate of population growth.

Over the medium term, growth is projected to remain positive but fragile. Mining, fishing and agriculture are expected to be key drivers of growth, with moderate expansion expected in construction, manufacturing, and wholesale and retail activities. These sectors are expected to collectively offset an anticipated contraction in the forestry sector in the near-to-medium term. Risks to the medium-term outlook are tilted to the downside, reflecting the country's vulnerability to natural disasters, a declining logging sector, and ongoing structural issues including an inefficient domestic transportation system, poor infrastructure, a narrow economic base and limited access to credit and financial services. The implementation of growth-stimulating policy priorities by the Government might also influence the country's economic trajectory. Externally, the country's medium-term outlook could also be affected by rising geopolitical tensions and weakening commodity prices.

Achieving high and sustained medium-to-long-term growth is necessary in order to appropriately cater for a growing population. This requires a strategic shift in policies to facilitate economic diversification and support firms along the export supply chain, as well as the enaction of inclusive and equitable development policies to ensure that the benefits of growth reach our large rural population. Furthermore, investing in modern agricultural techniques and equipment can increase yields and efficiency, while bolstering the country's digital infrastructure can drive investment and business activity. These initiatives should be aligned with the goals of the National Development Strategy 2035 so as to enhance the social and economic well-being of the people of Solomon Islands.

Table 1: Selected Economic Indicators, 2019-2025

Economic Indicators	2019	2020	2021	2022	2023	2024	2025
Global Economy 1/						Projections	
Economic Growth	Annual % change unless otherwise indicated						
World	2.8	-3.2	6.3	3.5	3.3	3.2	3.3
China	6.0	2.3	8.4	3.0	5.2	5	4.5
Australia 2/	1.9	-2.9	5.2	3.9	2.0	1.7	2.5
Inflation							
World	3.5	3.2	4.7	8.7	6.7	5.9	4.4
Australia 2/	1.8	0.9	3.5	7.8	4.1	3.0	3.7
Domestic Economy							
Economic Growth	Annual % change unless otherwise indicated						
Real GDP growth 3/	1.7	-3.4	2.6	2.4	4.0	3.0	2.7
Consumer Prices							
Headline Inflation (y-o-y, 3mma)	2.8	-1.8	2.8	9.5	3.5	2.5	2.5
Core Inflation (y-o-y, 3mma)	2.6	-1.4	1.5	8.1	3.5	2.4	2.0
Monetary Indicators	In percent of GDP						
Net foreign assets (NFA)	34.6	39.9	41.9	38.9	38.4	39.0	36.2
Private sector credit	19.8	20.8	21.4	20.7	20.4	20.0	19.5
Narrow Money (M1)	29.1	34.3	36.2	37.2	38.1	38.9	38.5
Excess Liquidity	12.0	17.2	19.4	19.5	16.4	16.4	16.2
Balance of payments	In percent of GDP unless otherwise indicated						
Current account balance	-9.5	-1.6	-5.1	-14.4	-10.7	-3.2	-10.7
Trade balance in goods	-2.3	-1.7	-6.4	-13.2	-12.3	-2.8	-9.5
Gross foreign reserves (in US$ m, eop)	576	661	695	660	688	686	663
Import cover (in months)	11.9	13.3	14.2	12.3	11.7	11.8	11.4
Exchange rate (SI$/US$, period avg)	8.2	8.2	8.0	8.2	8.4	8.4	...
Fiscal Indicators	In percent of GDP						
Fiscal balance (+ = surplus)	-2.6	0.8	-1.7	-2.9	-6.2	...	...
Government Revenue	28.0	33.9	30.3	27.8	25.3	...	...
Government Expenditure	30.6	33.1	32.0	30.8	31.6	...	...
Gross Government Debt	8.1	11.5	15.4	16.3	20.8	...	...

1/ IMF WEO July 2024 Update
2/ 2024 to 2025 GDP growth and inflation forecasts were sourced from Reserve Bank of Australia (RBA) Statement on Monetary Policy, August 2024.
3/ 2021 and 2022 figures are provisional growth estimates produced by the Solomon Islands National Statistics Office. The 2023 figure is the CBSI estimate.

4.2. Fiscal Outlook

Following the formation of the new Government towards the end of the first semester of 2024, the appetite for fiscal spending is anticipated to increase over the remainder of the year, as the Government begins to execute its new policy priorities. The deficit is expected to be equivalent to 3.7% of GDP in 2024, which is higher than earlier deficit projections of 3.0% of GDP. However, considering the proposed 2024 Supplementary Appropriation budget, the fiscal deficit may widen further.

The Central Government debt stock is anticipated to rise, in line with the projected deficit, to up to 28% of GDP by the end of the year, thus exceeding earlier forecasts of 25%. This projection considers a continued drawdown of existing loans, pipeline debt and a widening fiscal deficit for 2024. Additionally, considering a scenario where all of the Government's loan guarantees materialise, the debt-to-GDP ratio would escalate further, exceeding the 35% benchmark by year's end.

This outlook is subject to substantial downside risks, including a persistent deficit and inadequate cash reserves to fully finance the Government's budgeted programmes. This could lead to a continuous build-up in Central Government debt, driven by external pipeline loans as well as guarantees, if they materialise, which could be difficult to source domestically as borrowing options are gradually exhausted.

Over the medium term, the fiscal deficit is projected to hover around 3% of GDP. Unless the revenue base widens, this could imply a potential loss of fiscal sustainability, as Government spending is expected to exceed revenue persistently. Possible prudent actions the Government can take to mitigate such risks include ensuring a closer alignment of spending against domestic revenue, and the introduction of fiscal anchors to keep excessive spending pressures in check.

4.3. External Outlook

The outlook for the external sector in 2024 is weak, with a projected further narrowing of the current account deficit forecasted to be outweighed by an expected significant fall in the capital and financial account surplus. This outlook is reflective of a slowdown in capital imports and donor grants against the high levels recorded in the previous years, due to the phasing out of PGs-related construction projects.

Over the short-to-medium term, the current account deficit is projected to widen, on the back of higher capital imports and Government service payments as key pipeline and ongoing national projects gain momentum in the second half of 2024. Similarly, the capital and financial account is projected to broaden too, due to a projected increase in donor and FDI inflows in support of the roll-out of these key national projects.

Collectively, the build-up in capital projects, a decline in logging activity and the country's high dependence on imports are expected to exert pressures on the overall BOP position, resulting in a gradual reduction in the country's foreign reserves over the medium term.

However, risks in the external sector are tilted to the upside, as high FDI inflows, additional donor inflows, improved commodity prices for primary exports and the boost the La Niña effect can have on fish exports are all projected to cushion the expected adverse developments in the country's BOP position.

4.4. Monetary Outlook

The key monetary aggregates, including reserve money, broad money, and private-sector credit are all projected to grow in 2024 in line with the projected expansion in economic activity and supported by fiscal-policy expansion. They are then anticipated to remain moderate in the medium term, reflecting a positive outlook for the economy. Nonetheless, projections of declines in the country's foreign reserves could dampen the outlook on NFA and related monetary aggregates over the same horizon.

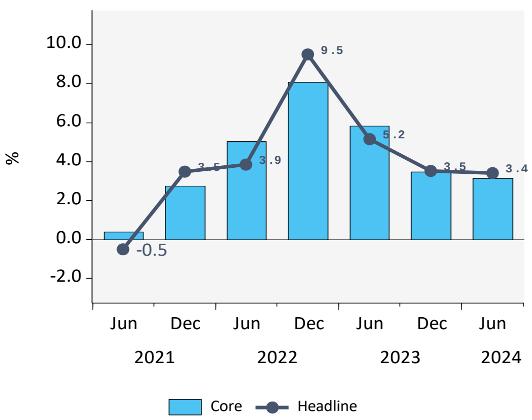
5. Inflation Developments and Outlook

5.1. Inflation Developments

Solomon Islands' headline and core inflation continued on a disinflationary trajectory during the first semester of 2024, down from the peak recorded in 2022 (see Figure 15 below). Headline inflation eased slightly to 3.4% in June 2024 from the 3.5% recorded in December 2023, driven by a slowdown in imported inflation, which decreased from 4.7% in December 2023 to 3.2% in

June 2024. This reflects a stabilisation in world crude oil prices after a temporary spike in October 2023.

Figure 16: Headline and Core Inflation

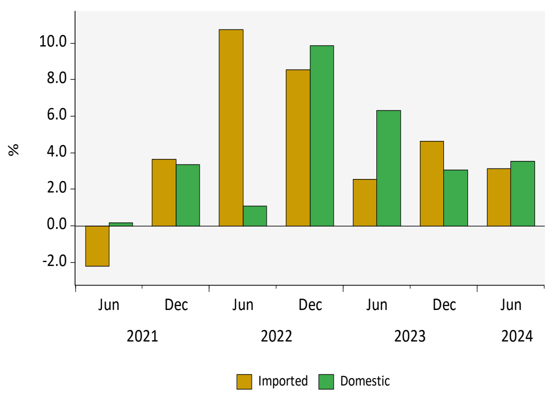


Source: SINSO, CBSI

On the other hand, domestic inflation increased from 3.1% in December 2023 to 3.6% in June 2024, due to supply-side factors, particularly the episodes of heavy rain experienced at the beginning of the year which led to higher prices for garden root crops and betelnut.

Core inflation[7] declined to 3.2% in June 2024 from 3.5% in December 2023, driven primarily by easing prices in clothing and recreation activities. Although inflationary pressures emanating from core have moderated over the period, it currently remains above 3%, reflecting persistent downward rigidities in price-setting and ongoing logistical challenges as high costs of shipping filter through to the rest of the economy.

Figure 17: Imported and Domestic Inflation



Source: SINSO, CBSI

In light of the inflationary developments, it is worth highlighting the distinction between disinflation and deflation. The currently observed disinflationary trend implies that prices are rising more slowly than they had been previously. In contrast, deflation occurs when prices decline, resulting in negative inflation rates. Consumers often prefer deflation, as it allows them to purchase goods and services at lower prices than they used to. However, Central Banks typically aim for low but positive inflation, and disinflation is the process of slowing price increases following periods of high inflation. Meanwhile, deflation is often associated with technological development, such as a transition from power generated using imported fuel to renewable energy that lowers energy prices, or improvements in telecommunication technologies that bring down the per-unit price of internet data packages.

5.2. Inflation Outlook

Headline inflation had been projected to reach 5.1% in June 2024, according the March 2024 MPS. The rate of price rises however declined even further, dipping to 3.1%. The lower-than-expected inflationary pressures may be attributed to the following factors:

- Stabilisation of international oil prices from the temporary upsurge witnessed in August to October 2023. This reflected coordinated efforts by oil-producing countries to maintain steady production levels in the first half of the year even in spite of ongoing geopolitical tension;

- The swift response by the Solomon Islands Government in repairing damaged bridges and roads on the outskirts of Honiara that had been affected by heavy rains earlier in the year. These repairs restored market access for vendors and minimised supply disruptions in the second quarter of 2024 for market root crops, vegetables, fruits, and betelnut;

- The policy responses implemented by the Central Bank, Government and state-owned enterprises to address inflation concerns and prevent it from escalating further.

Against this backdrop, headline inflation is forecast to ease to 2.5% at the end of 2024 and to fluctuate around

[7] Core inflation excludes items subject to price control, excise taxes and volatile items, namely food and energy items.

the 2% mark in March 2025, when the next bi-annual MPS assessment will be carried out. These projections are made in consideration of further stabilisation of fuel prices and a modest rise in imported food prices, particularly rice, in the second half of 2024. The primary contributors to inflation over the next six months are expected to come from food, housing and energy, with domestic factors predicted to have a more pronounced impact than imported factors. Moreover, while the outlook for inflation remains modest, goods whose prices are sensitive to seasonal factors, such as betelnut, may experience a greater amount of fluctuation over the coming semester.

On the other hand, core inflation stood at 3.2% in June 2024, consistent with forecasts in the March 2024 MPS. It is then expected to ease further to 2.4% in December 2024 and to 2.1% in March 2025. These forecasts remain largely unchanged from earlier projections, as price dynamics depend in large part on structural issues within the economy, such as market competition, production costs, and economies of scale.

The risks to inflation are more balanced now than they had been in the March 2024 MPS forecast, where they had been weighed to the downside. Improved road and bridge connectivity in the outskirts of Honiara and the opening of new market facilities for vendors in the capital city are expected to increase the supply of garden crops and vegetables, thus potentially leading to lower prices. Additionally, global inflation is anticipated to continue to ease, albeit slowly, and international fuel prices are proving more stable than initially anticipated.

However, ongoing geopolitical tensions continue to pose a serious risk to this outlook, as sudden flare-ups could have an impact on commodity prices and percolate through into our domestic inflation. Furthermore, the retail selling price for rice in Honiara recorded a significant increase in July 2024, and it is anticipated to remain high in the coming months in light of elevated rice prices globally. Weather-related risks also persist, as the country currently remains under a La Niña watch. The La Niña effect is usually associated with higher-than-normal rainfall patterns, which could result in unexpected price fluctuations. As for core inflation, inefficiencies in road congestion and relatively high international shipping costs may also discourage firms from lowering prices quickly.

Overall, considering the balanced near-term risks, there is an equal chance that headline inflation could drop further or rise faster than forecasted, depending on movements in global prices and domestic supply factors. If global prices continue to decline, headline inflation could well ease further than the forecast of 2.5%. Meanwhile, if a sudden surge in global prices or negative supply shocks were to affect our country, inflation may edge comparatively higher.

6. Monetary Policy Stance

In light of the recent disinflationary trajectory over the first six months of the year, and in expectation of a continued easing of inflation, the CBSI has resolved to adopt an accommodative monetary policy stance to support economic activity over the next six months. However, the Bank will remain vigilant to upside risks on inflation, and it shall consider taking action as appropriate should any adverse macroeconomic shocks occur with the potential to jeopardise price or financial stability.