INTERNATIONAL MONETARY FUND

IMF Country Report No. 23/162

SOLOMON ISLANDS

May 2023

2023 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2023 Article IV consultation with Solomon Islands, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse-of-time basis, following discussions that ended on February 21, 2023, with the officials of Solomon Islands on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 7, 2023.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the IMF staff.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund

Washington, D.C.

PRESS RELEASE

PR23/149

IMF Executive Board Concludes 2023 Article IV Consultation with Solomon Islands

FOR IMMEDIATE RELEASE

Washington, DC – **May 12, 2023:** On April 26, 2023, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Solomon Islands and endorsed the staff appraisal without a meeting on a lapse-of-time basis.[2]

The economy is recovering from the shocks of civil unrest in November 2021 and a local outbreak of COVID-19 in early 2022, driven by increasing activity after the reopening of the border and preparation for the 2023 Pacific Games. But the recovery has been fragile, as Russia's war in Ukraine has led to a decline in the terms of trade and rising inflation.

The growth rate is projected at 2.5 percent for 2023. Annual inflation is expected to moderate from 8.5 percent at end-2022 but remain at 4.2 percent at end-2023. The current account deficit and fiscal deficit are projected to widen to 12.6 percent and 6.3 of GDP in 2023, respectively, reflecting higher global commodity prices, imports for the Pacific Games, and the significant fiscal costs of the Pacific Games and the general elections scheduled for early 2024. The financial sector remains capitalized and profitable, while commercial banks' credit to the private sector remains subdued.

Both current account and fiscal deficits are expected to persist over the medium-term. In particular, the current account deficits are projected to remain elevated, reflecting the decline in log production, slowing potential growth of China, and high imports for infrastructure projects. Foreign reserves are forecast to decline to 6.3 months of imports by 2027, although they would still be within the adequacy range at this lower level. The public debt-to-GDP ratio is projected to reach the authorities' threshold of 35 percent in 2031, driven by concessional external borrowing for infrastructure projects and increasing domestic financing.

Executive Board Assessment

In concluding the 2023 Article IV consultation with Solomon Islands, Executive Directors endorsed the staff's appraisal, as follows:

The economy is recovering from multiple shocks in the past three years, but the recovery is still fragile. The reopening of the border and infrastructure spending ahead of the 2023 Pacific Games have accelerated the recovery from civil unrest and the local outbreak of

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

COVID-19, but rising living and business costs have been a drag. The economy remains subject to downside risks, including a potential resurgence of the COVID-19 pandemic, natural disasters, increases in global commodity prices, and recurrent political instability. Both fiscal and current account deficits are expected to persist in the medium-term, driven by large spending on infrastructure, other tangible and human capital development, and declining log exports. Reserve coverage is expected to decline as a result, although it is forecast to remain within the adequacy range under the baseline.

Near-term fiscal policy should focus on prudent execution of the 2023 budget, followed by rebuilding of the government's cash balance. Expenditures related to the Pacific Games and the general elections need to be well controlled to minimize the risk of crowding out of other essential spending, including targeted support for the vulnerable and other investment for future growth. IMF staff welcomes the publication of the results of audits of COVID-19 related expenditures and recommends that the OAG also audit expenditures related to the Pacific Games and publish the results. Once the recovery is secured after the Pacific Games, rebuilding the government's broad cash balance to at least two months of total spending should be prioritized.

Prudent management of public investment projects including their financing arrangements is an urgent priority. Public investment projects need to be phased in line with the economy's absorptive capacity and accompanying financing arrangements should be carefully negotiated, to mitigate fiscal risks and ensure external balance and debt sustainability. Reforms to improve the quality and accountability of public expenditure, including through improving PFM and reviewing the CDF Act, need to be accelerated. Significant revenues could be mobilized through the completion of the tax administration modernization project and the planned introduction of a VAT.

Staff welcomes the recent decision by the CBSI to tighten the monetary policy stance, which underscores its readiness to address inflation while paying due attention to economic growth. The CBSI should stand ready to further adjust its policy stance in case inflationary pressures persisted. It should also avoid additional purchases of government bonds, to safeguard macroeconomic stability and the independence of the central bank. The central bank is encouraged to continue its efforts to improve capacity, including for economic analysis and forecasting, monetary policy communication, and the internal audit function.

The current exchange rate regime remains appropriate, but a timely review of the currency basket is called for, given changes in trade patterns. Solomon Islands' external position in 2022 is assessed to be substantially weaker than the level consistent with medium-term fundamentals and desirable policies. While other policies will need to adjust to restore balance, notably on the fiscal side, maintaining external competitiveness will also be critical, especially given that Solomon Islands' trade structure has changed materially over the past decade.

Increasing bank lending and enhancing financial integrity remains a challenge. Reforms to moderate credit risks for commercial banks such as reducing asymmetric information and facilitating enforcement of contracts, as well as to promote digital financial services, could spur credit growth. Strengthening legal and supervisory frameworks for AML/CFT and raising awareness of the risks are essential for ensuring integrity of Solomon Islands' financial systems.

Developing new growth drivers, including by enhancing natural resource wealth management, market regulation, and addressing governance weaknesses and corruption vulnerabilities, is an urgent priority. Frequent land disputes and ineffective dispute resolution mechanisms remain long-standing obstacles to private sector development. Strengthening governance and fiscal frameworks for the mining sector including through legislation and rejoining the EITI is needed to utilize the country's rich natural resources in a sustainable and inclusive manner. Progress in governance reforms and anti-corruption efforts would be further supported by strengthening the independence and capacity of anti-corruption institutions and by strengthening the OAG by amending its legal framework consistent with IMF technical assistance recommendations.

The IMF continues to support capacity development of the authorities in collaboration with development partners. Immediate CD priorities include the reporting and auditing of public spending; public investment management; review of the exchange rate basket; the central bank's internal audit; and economic statistics such as the national accounts, government financial statistics, and household and labor force surveys.

It is proposed that the next Article IV consultation takes place on the standard 12-month cycle.

Table 1. Solomon Islands: Selected Economic Indicators, 2018–2027

Per capita GDP (2022): US$2,265
Population (2020): 686,878
Poverty rate (2006): 23 percent
Quota: SDR 20.8 million

	2018	2019	2020	2021	2022 Est.	2023 Proj.	2024	2025	2026	2027
GROWTH AND PRICES	Annual percentage change unless otherwise indicated									
Real GDP	2.7	1.7	-3.4	-0.6	-4.1	2.5	2.4	3.0	3.0	3.0
CPI (period average)	3.5	1.6	3.0	-0.1	5.5	4.8	3.7	3.3	3.3	3.3
CPI (end of period)	3.8	2.7	-2.5	3.5	8.5	4.2	3.3	3.3	3.3	3.3
GDP deflator	7.9	1.2	-1.3	1.1	7.0	4.7	3.4	3.4	3.2	3.2
Nominal GDP (in SI$ millions)	12,847	13,234	12,617	12,690	13,021	13,980	14,807	15,772	16,761	17,826
CENTRAL GOVERNMENT OPERATIONS	In percent of GDP									
Total revenue and grants	31.7	27.4	30.1	27.1	27.7	24.8	26.4	26.9	26.7	26.6
Revenue	29.2	25.8	24.6	22.6	23.0	23.0	24.3	25.0	24.8	24.7
Grants (budgetary)	2.5	1.6	5.5	4.5	4.7	1.8	2.0	1.9	1.9	1.9
Total expenditure	30.2	29.0	32.6	30.7	31.8	31.1	30.9	30.2	30.0	29.9
Recurrent expenditure	25.1	25.4	27.7	26.1	26.5	22.8	22.7	22.7	22.9	23.1
Development expenditure	5.1	3.6	4.9	4.6	5.4	8.3	8.2	7.5	7.1	6.8
Overall balance	1.5	-1.5	-2.4	-3.6	-4.1	-6.3	-4.5	-3.4	-3.3	-3.3
Foreign financing (net)	-0.1	0.0	1.4	1.1	0.3	2.6	5.8	5.2	3.1	2.9
Domestic financing (net)	-1.4	1.5	1.0	2.6	0.6	3.2	2.8	2.0	3.1	3.1
Central government debt 1/	7.9	7.9	13.5	15.4	16.9	22.2	25.7	27.8	29.3	30.8
MACROFINANCIAL	Annual percentage change (end of year)									
Credit to private sector	4.1	6.1	0.3	-0.4	0.8	2.0	3.5	5.0	5.0	5.0
Broad money	6.8	-3.1	6.6	1.9	5.3	6.3	1.4	1.2	0.9	0.7
Reserve money	10.3	-7.1	23.0	10.6	4.0	2.1	1.4	1.2	0.9	0.7
BALANCE OF PAYMENTS	In US$ millions unless otherwise indicated									
Trade balance (goods and services)	-67.6	-161.6	-127.4	-205.4	-335.1	-313.4	-309.9	-319.2	-299.5	-304.4
(percent of GDP)	-4.2	-10.0	-8.3	-13.3	-21.0	-18.4	-17.2	-16.6	-14.7	-14.0
Current account balance	-47.8	-154.0	-25.1	-78.3	-212.1	-214.9	-183.9	-187.8	-161.1	-156.5
(percent of GDP)	-3.0	-9.5	-1.6	-5.1	-13.3	-12.6	-10.2	-9.8	-7.9	-7.2
Foreign direct investment (+ = decrease)	-15.9	-28.7	-5.7	-23.1	-39.5	-41.9	-44.1	-46.6	-49.2	-51.9
(percent of GDP)	-1.0	-1.8	-0.4	-1.5	-2.5	-2.5	-2.4	-2.4	-2.4	-2.4
Overall balance (+ = decrease)	-57.4	33.8	-73.1	-38.3	5.6	85.2	28.4	48.5	15.4	33.5
Gross official reserves (in US$ millions, end of period) 2/	613.1	574.1	660.6	694.5	641.0	560.7	541.7	498.9	485.5	453.8
(in months of next year's imports of GNFS)	9.8	12.4	12.8	11.5	9.5	8.4	8.0	7.4	7.0	6.3
EXCHANGE RATE (SI$/US$, end of period)	8.1	8.2	8.05	8.10	…	…	…	…	…	…
Real effective exchange rate (end of period, 2010 = 100)	126.9	127.5	129.9	124.8	…	…	…	…	…	…
MEMORANDUM ITEMS:										
General Government Development Spending (in SI$ millions)	963	1,100	696	923	1,483	1,291	1,295	1,320	1,348	1,405
Cash balance (in SI$ millions)	311	206	206	137	137	137	137	137	137	137
in months of recurrent spending	1.3	0.7	0.8	0.5	0.5	0.5	0.4	0.4	0.4	0.4
SIG Deposit Account										
(In addition to cash balance, in SI$ millions)	140	140	120	120	231	231	231	231	231	231
Broader cash balance										
(=Cash balance+ SIG Deposit Account; in SI$ millions)	451	346	326	257	367	367	367	367	367	367
in months of total spending 3/	1.5	1.1	1.1	0.8	0.9	0.8	0.7	0.7	0.7	0.6
Public domestic debt, including arrears (in SI$ millions)	2	2	4	6	6	8	11	12	14	16

Sources: Data provided by the authorities; and IMF staff estimates and projections.
1/ Includes disbursements under the IMF-supported programs.
2/ Includes SDR allocations made by the IMF to Solomon Islands in 2009 and in 2021, and actual and prospective disbursements under the IMF-supported programs.
3/ Total spending is defined as total expenditure, excluding grant-funded expenditure.

INTERNATIONAL MONETARY FUND

SOLOMON ISLANDS

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION

April 7, 2023

KEY ISSUES

Context. The economy is recovering from the shocks of civil unrest in November 2021 and a local outbreak of COVID-19 in early 2022, driven by increasing activity after the reopening of the border and preparation for the 2023 Pacific Games. But the recovery has been fragile, as Russia's war in Ukraine has led to a decline in the terms of trade and rising inflation. A large pipeline of infrastructure projects financed by concessional borrowing is expected to support medium-term growth and help reduce a large infrastructure gap. But the country's external position is projected to significantly weaken because of these projects and declining log exports, with reserve coverage declining as a result. This outlook highlights the pressing needs for reform to improve public investment management, as well as to diversify the economy and enhance its competitiveness.

Main policy recommendations.

- **Fiscal policy**. Expenditures related to the Pacific Games and the general elections should be tightly controlled to avoid crowding out of other essential spending, including on targeted support for the vulnerable suffering from higher living and business costs. Once the recovery is secured, fiscal policy should prioritize restoring the government's cash balance to reduce liquidity risks. While mobilizing public investment in physical and human capital will be the subsequent fiscal priority, projects need to be phased in line with the economy's absorptive capacity and accompanying financing arrangements should be carefully negotiated to preserve fiscal and external sustainability. Reforms to improve the quality and accountability of public expenditure and raise domestic revenue are key to achieve these priorities.
- **Monetary and exchange rate policies**. The central bank should phase out accommodative monetary measures, given recovery and rising inflation. The current exchange rate regime remains appropriate but reviewing the currency basket is needed to prevent potential exchange rate misalignment and maintain external balance.
- **Structural reforms**. Addressing structural bottlenecks including frequent land disputes and ineffective dispute resolution mechanisms is needed to mobilize private investment and generate new sources of inclusive growth. Modernizing legal and regulatory frameworks and strengthening anti-corruption and auditing institutions remain critical for mitigating governance vulnerabilities and corruption risks.

Approved By
Thomas Helbling (APD) and Boileau Y. Loko (SPR)

Discussions took place in Honiara during February 8–21, 2023. The staff team comprised M. Yabara (head), S. Cagilaba, R. Merga, and I. Yakadina (all APD). N. Saker (Resident Representative, Pacific Islands), M. Mohlala (FIN), C. Y. Tan (LEG), and T. Doss (OED) joined some of the meetings. T. Dao, E. Das, and C. Reis (all APD) provided excellent research and editorial assistance. G. Cugat (RES), a previous team member, contributed to the report. The mission met with the Prime Minister M. Sogavare, Minister of Finance and Treasury H. Kuma, Governor of the Central Bank of Solomon Islands L. Forau, other government officials, parliamentary members, private sector representatives, civil society organizations, and development partners.

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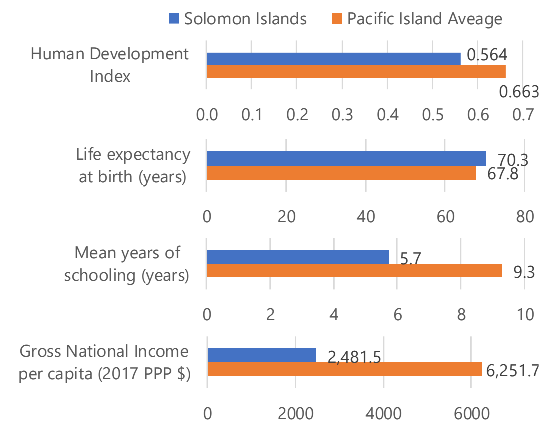
CONTEXT

1. **Solomon Islands is a small, low-income, and fragile state with a young population**. The country is geographically dispersed comprising of almost a thousand islands. Three quarters of the 0.7 million population live in rural areas, speaking over 120 languages and largely relying on subsistence or semi-commercial agriculture and fisheries. About 40 percent of the population is below 15 years of age, with the population growing by more than 2 percent every year. The country has made significant strides since the end of the internal conflict in 2003 but continues to face development challenges, driven by geographical dispersion; long-standing socio-economic tensions; vulnerability to natural disasters and climate change; infrastructure gaps; and weak institutions and governance (Annex III. Country Engagement Strategy). Solomon Islands has a low ranking on the Human Development Index, 155th out of 191 countries.

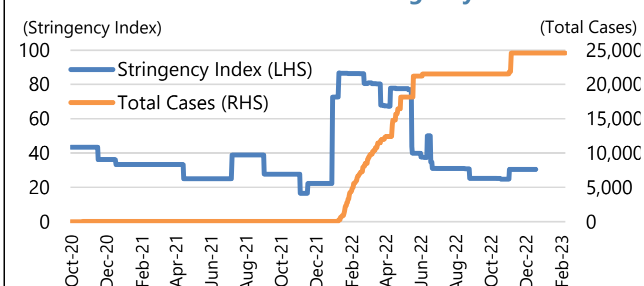
Human Development Index and its Components



Source: United Nations Development Programme.

2. **The economy has been hit by multiple shocks**. Internal political tensions escalated to civil unrest in Honiara in November 2021. Widespread looting and rioting caused significant destruction, estimated at 7 percent of GDP, and the loss of around 1,000 jobs. The country experienced its first local outbreak of COVID-19 in early 2022, which temporarily grounded economic activity to a halt owing to mobility restrictions. The economy was further hit by the economic impacts of Russia's war in Ukraine, just as recovery from the riot and the pandemic was about to begin following the removal of the mobility restrictions and reopening of the border in July 2022. The country has two important events coming up—the hosting of the Pacific Games in November 2023 and the general elections in early 2024.

COVID-19 Cases and Stringency Index



Source: One World In Data.
Note: Stringency Index is a composite measure of 9 response metrics, with higher scores indicating stricter responses.

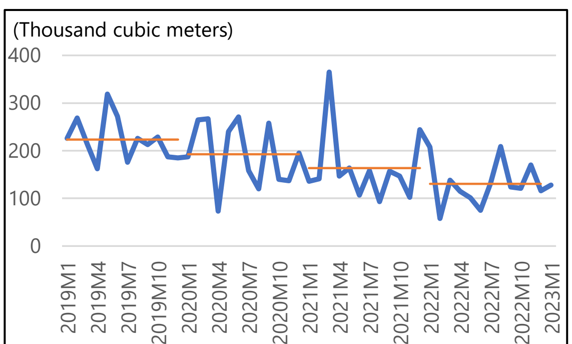
3. **A large pipeline of infrastructure projects offers promise of development and growth but comes with risks**. Large infrastructure projects are planned in Solomon Islands between 2022 and 2027, to be financed by disbursements of concessional loans from donors (e.g., World Bank, Asian Development Bank, and European Union), amounting to around 3 percent of GDP per year. While the projects come at an opportune time promising development and growth, large capital expenditures associated with the projects could jeopardize external and fiscal sustainability, without effective frameworks to manage the program, as indicated, for example, by projected increases in

external debt and decreases in reserve coverage. Developing new growth drivers and diversifying exports is an increasingly pressing issue, since output of the logging sector—a key source of exports and revenue—has kept declining, owing to overexploitation of resources and slowing demand in foreign markets.

RECENT DEVELOPMENTS: NASCENT BUT FRAGILE RECOVERY

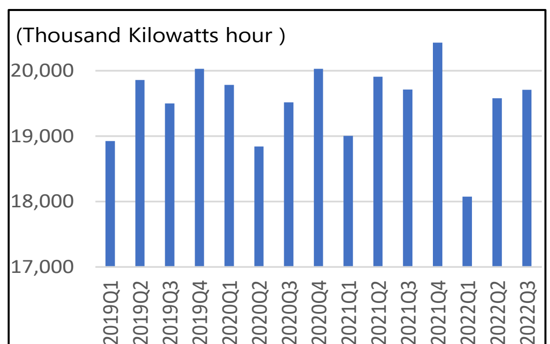
4. **The economy is recovering from the shocks**. The riot in November 2021 and the community transmission of COVID-19 in early 2022 adversely affected the economy in the first half of the year: the production of round logs and electricity usage decreased by 25 percent and 3.2 percent, respectively, compared to the same period in 2021. Economic activity started to increase gradually in the second half of the year, as the direct impacts of the two shocks dissipated, as indicated by high frequency indicators including port activity (Annex IV. Using Big Data to Fill Data Gaps for Solomon Islands). COVID-19 related restrictions, including at the borders, were fully removed in July 2022. But the pace of the recovery has been slower than expected at the time of the last Article IV Consultation since Russia's war in Ukraine war led to worsening of the terms of trade and to rising living and business costs. Reflecting the impact of the shocks in the first half of 2022, real GDP is estimated to have contracted by 4.1 percent in the full year, marking the third consecutive year of negative growth.

Production of Round Logs



Source: Central Bank of Solomon Islands and staff estimates.

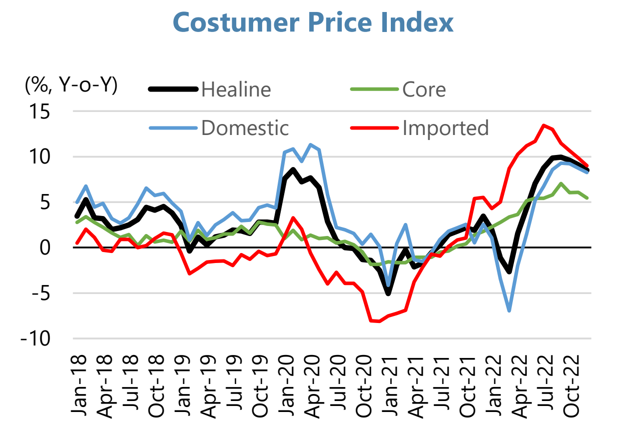
Sales of Electricity



Source: Central Bank of Solomon Islands.

5. **Higher global prices have translated into rapidly rising inflation in Solomon Islands**. Annual inflation accelerated sharply from -2.7 percent in March 2022 to 9.9 percent in September, and then declined to 8.5 percent in December. The acceleration was initially driven by higher import prices, followed by passthrough to domestic prices. The Central Bank of Solomon Islands (CBSI) maintained accommodative monetary policy during 2022 to support the recovery. Specifically, the CBSI maintained the Cash Reserve Requirement for commercial banks at 5 percent and the stock of central bank bills (the Bokolo Bills) at SI$430 million, measures that were introduced in June 2020 in

response to the pandemic. The government temporally cut import duty and sales tax on fuel imports to help mitigate inflationary pressures.[1]



Source: Central Bank of Solomon Islands.

6. The external balance is expected to have deteriorated significantly, although foreign reserves have remained at prudent levels. The deterioration of the terms of trade caused by Russia's war in Ukraine is estimated to have widened the current account deficit to 13.3 percent of GDP in 2022. Exports were dragged down by border closures and mobility restrictions in the first half of 2022 as well as weak demand from key export destinations, mainly China. A rise in remittance inflows underpinned by the labor mobility scheme under the Pacific Economic Agreement on Closer Economic Relations (PACER Plus) is estimated to have partially offset the worsening external balance. Gross official reserves are expected to have lowered to 9.5 months of prospective imports in 2022, staying well above the reserve adequacy range of four to seven months of imports. Continued aid inflows, albeit declining, have supported reserve coverage.

7. Weak planning and delayed approval of the 2022 budget appear to have resulted in budget underexecution. The regular 2022 budget prioritized expenditures on COVID-19 response and post-riot reconstruction. It included an economic stimulus package estimated at 2.3 percent of GDP, consisting of temporary measures, such as tax relief, cash transfers for reconstruction of damaged properties, import duty exemptions, and fast-tracking of construction approvals. But COVID-19 related restrictions delayed the parliamentary approval of the budget until April 2022[2], preventing the full implementation of the budget. It appears that public expenditure was further restricted by a significant revenue shortfall in early 2022 due to the riot and COVID-19, donor support falling short of expectations in the budget[3], and the shallow domestic bond market constraining domestic financing. As a result, the fiscal deficit is estimated to have become smaller than expected at the time of the budget approval, amounting to 4.1 percent of GDP in 2022, even after the formulation and implementation of a supplementary budget that authorized the additional expenditure of SI$284 million (2.1 percent of GDP) reflecting realized donor support and additional spending needs.

[1] These measures were first introduced in July 2022 and expired at end-2022.

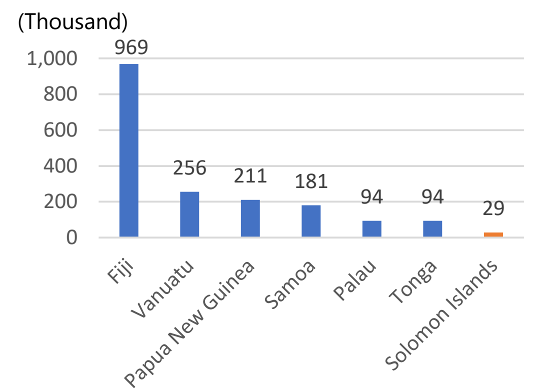
[2] Solomon Islands' fiscal year starts on January 1 and ends on December 30.

[3] The Solomon Islands government submits budget bills to the parliament incorporating expenditures to be financed by donor grants, without obtaining prior commitments from development partners, presenting unduly large overall deficits and financing gaps. This practice has occasionally resulted in lower expenditures and/or domestic payment arrears, limiting the usefulness of the budget as a guide to fiscal policy and making comparisons between budgets and outturns difficult.

Box 1. Tourism Sector of Solomon Islands[1]

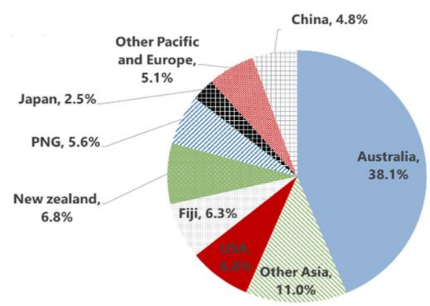
Solomon Islands' tourism sector is at a nascent stage of development, offering prospects for growth. Tourism contributed around 5 percent of GDP and less than 1 percent of the total employment before the pandemic but has a significant growth potential thanks to the country's untouched beautiful nature and rich cultural traditions. The number of international arrivals stood at 28,907 in 2019, achieving an 8 percent annual growth over the past five years, but lagging more established tourist destinations in the Pacific. About half of the arrivals were returning residents, and the other half were visitors. 32 percent of the visitors were tourists, followed by 24 percent for businesses. In terms of country of residency, people living in Australia accounted for 38 percent of the total arrivals during 2019, followed by the US (6.8 percent), New Zealand (6.8 percent), and Fiji (6.3 percent).

International Arrivals



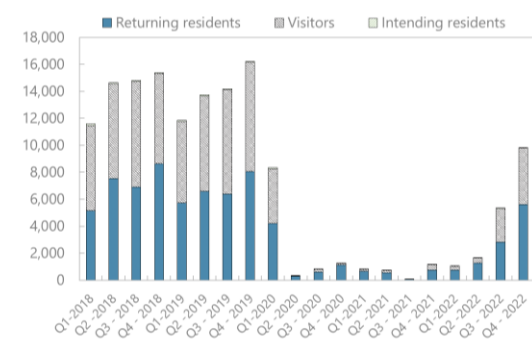
Source: World Bank, World Development Indicators.

Composition Arrivals
(2019)



Sources: Solomon Island authorities and IMF staff calculations.

Arrivals by Purpose



Sources: Solomon Island authorities and IMF staff calculations.

Visitor arrivals significantly increased after the reopening of the border in July 2022, being expected to continue picking up in the coming quarters. 4,207 visitors arrived at the country during the fourth quarter of 2022, registering a 70 percent increase from the third quarter. The number of visitors in the second half of 2022 recovered to 42.3 percent of visitor arrivals for the same period in 2019. 29 percent of them were for tourism purposes, while 31 percent of them were for businesses. The numbers of visitors are expected to continue increasing, as they will recover to the pre-pandemic levels and people will visit the country to watch the Pacific Games in November 2023.

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[1] Prepared by Roman Merga (APD).

OUTLOOK AND RISKS

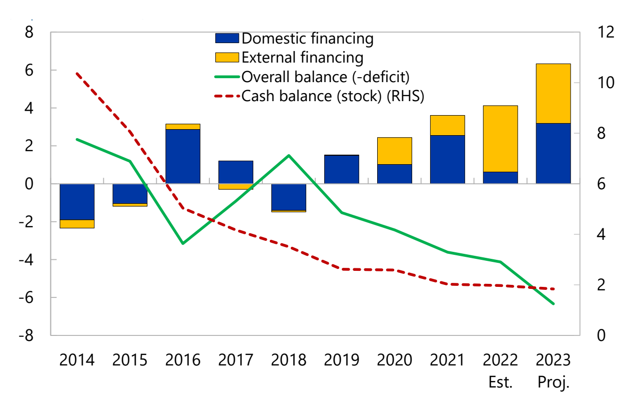
8. The economy is expected to grow in 2023, but above-average inflation would persist. Real GDP is forecast to grow by 2.5 percent in 2023, driven by increasing economic activity towards the 2023 Pacific Games and large infrastructure projects. Inflation is projected to moderate but remain at 4.2 percent at end-2023, as domestic prices are anticipated to remain high. It is expected that a large pipeline of externally financed infrastructure projects would continuously support growth beyond 2024, while the general elections scheduled for early 2024 could temporarily stall economic activity, as was the case in the 2019 elections. Declining logging activity, driven by the depletion of resources and slower potential growth of China, would weigh on medium-term growth. Hence, the economy is forecast to grow by around 3 percent over the medium term.

9. The current account deficit-to-GDP ratio is expected to remain elevated in the medium term, raising concerns about external sustainability. It is projected to stay high at 12.6 percent of GDP in 2023, driven by construction activity including for the Pacific Games. Reopening of the Chinese economy is expected to increase demand for timber products, but the impact on Solomon Islands' exports would be limited by the structural decline in log production capacity. The current account deficits are forecast to remain elevated in the medium term, reflecting continuous declines in logging activity, a slowdown in China's potential growth, and progress in the execution of large, multi-year infrastructure projects. Growth of mineral exports and remittances are expected to partially offset the impact of declining log exports.[4] As a result, foreign reserves are projected to decline further to 6.3 months of imports by 2027, although they would still be within the adequacy range at this lower level. External grants from donors, while projected to decline in the medium term, are expected to remain a key source for foreign reserves.

10. The 2023 budget aims to support growth and accommodate the Pacific Games and the general elections preparations. The 2023 budget, approved by parliament in December 2022, includes targeted support for the vulnerable suffering from rising living and business costs, such as supporting market access of farmers in rural areas, while withdrawing measures introduced in response to the 2021 civil unrest and the local outbreak of COVID-19. It emphasizes transformational investments in productive capacity sectors such as agriculture and fisheries, transportation, mining, digital communication, and tourism, within the tight budget allocations. Human capital investment in education and health is also prioritized to empower people and

Fiscal Balance and Financing

(In Percent of GDP)



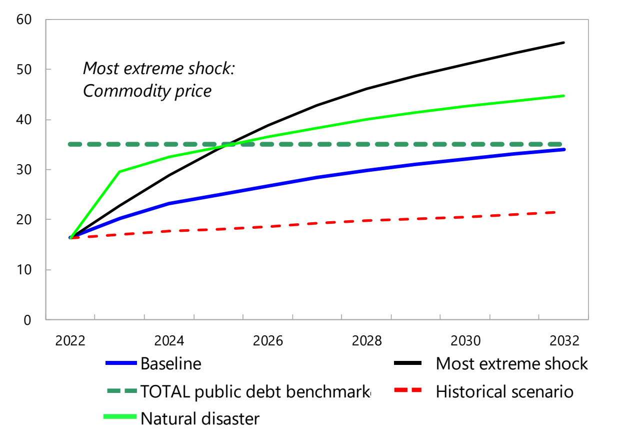
Source: IMF staff calculations.

[4] Gold exports from Gold Ridge Mine was resumed in December 2022.

promote national unity, given the high share of young people in the population. The Pacific Games and the general elections consume a significant portion of the 2023 budget, 4.6 percent of GDP, contributing to a large fiscal deficit of 6.3 percent of GDP. The one-off spending for these two events risks crowding out other priority spending, including on health and education, and possible spending overruns may result in renewed accumulation of arrears. Donor grants are expected to decline in 2023, reflecting the withdrawal of donor support for addressing the end-2021 riot and the COVID-19 community transmission.

11. Fiscal deficits are expected to persist going forward, and public debt is projected to increase in the medium term. Large spending needs for improving physical and human capital, costs to maintain newly built infrastructure, and continued weak revenue trends including from declining log exports are main drivers for the continued fiscal deficits. The public-debt-to-GDP ratio significantly increased during the pandemic from 7.9 percent in 2018 to an estimated 22.2 percent in 2023 and is projected to reach the authorities' policy threshold of 35 percent of nominal-debt-to-GDP ratio in 2031. The Debt Sustainability Analysis (DSA) indicates moderate risk of debt distress with substantial space to absorb shocks. However, Solomon Islands faces significant liquidity challenges due to the low government cash balance and rising fiscal risks, including from potentially unfunded liabilities associated with the maintenance costs of large infrastructure projects. The outlook on debt is also subject to risks driven by the country's fragility, such as undiversified economic base, vulnerabilities to natural disasters, high aid dependency, and political instability (Annex III. Country Engagement Strategy), as illustrated by a set of stress tests and a risk scenario.

Present Value of Public Debt-to-GDP Under Alternative Scenarios



12. The outlook is subject to significant uncertainty, with risks skewed to the downside (Annex I. Risk Assessment Matrix). An outbreak of COVID-19 in a remote province and a 7.0 magnitude earthquake in November 2022, although their economic impacts were limited, highlight the risk of a resurgence of the pandemic and the country's vulnerability to natural disasters. The risk of the pandemic is exacerbated by the slow progress in vaccination. Lower-than-expected support from development partners or unsuccessful bond issuance in the shallow domestic market could hinder the implementation of the 2023 budget or cause payment arrears. Higher inflation due to further rises in global commodity prices as well as delays in infrastructure projects would discourage the recovery. Other downside risks include political instability in the runup to the general elections and rises in geopolitical tensions. Upside risks include a stronger than expected global recovery and acceleration of aid inflows motivated by geopolitical considerations.

Authorities' Views

13. **The authorities broadly agreed with staff's assessments on the economic outlook and risks.** They are focused on supporting the ongoing recovery, seeing the current economic conditions as an opportunity to address long-term challenges towards sustainable and inclusive growth. While expecting somewhat faster moderation of inflation than staff, the authorities recognize the risks from inflation remaining elevated, driven by higher international commodity prices or strong domestic economic activity. The authorities project smaller current account deficits and slower declines in reserve coverage over the medium term, in part because of higher expected remittances, but they agreed on the need for developing stable sources of foreign exchange receipts in the private sector. The authorities are aware of risks of widening fiscal deficits and rising public debt, highlighting the importance of expenditure control, domestic revenue mobilization, and support from development partners.

ECONOMIC POLICIES

14. **Solomon Islands faces the near-term challenge of securing the nascent recovery while also containing inflation.** The successful hosting of the 2023 Pacific Games and preparations for the general elections in early 2024 are near-term priorities for the authorities. Both entail significant fiscal costs. Beyond these priorities, IMF staff recommends that the authorities use a policy mix of targeted fiscal support for the vulnerable suffering from rising inflation and a reversal of the accommodative monetary measures during the pandemic. IMF staff also underscores the urgent need for accelerated reforms to improve public investment management, as well as to address the medium-term challenge of diversifying the economy and enhancing its competitiveness.

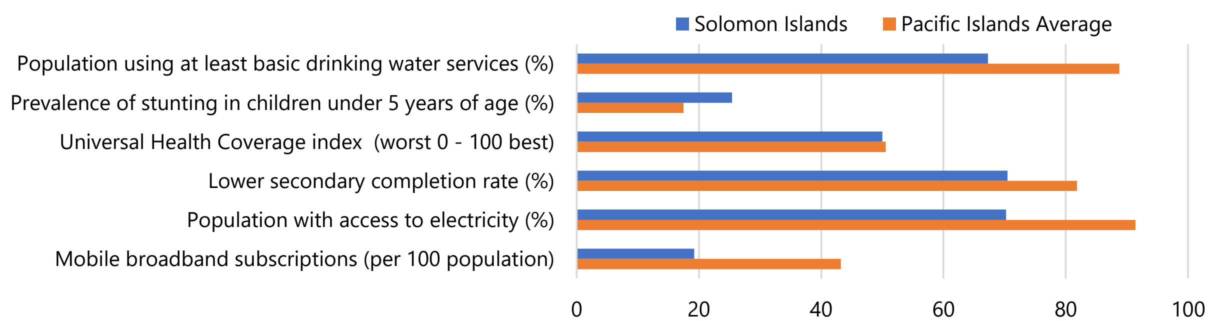
A. Fiscal Policy

15. **The authorities' near-term fiscal stance as presented in the 2023 budget is broadly appropriate but exceptional expenditures need to be well controlled.** The budget aptly aims to ensure the recovery and accelerate investment for sustainable and inclusive economic growth. Staff welcomes the withdrawal of crisis-response measures and expiration of the temporary exemption of tax and duty for fuel imports at end-2022. Promoting national unity through human capital investment, one of two pillars of the budget, is key to addressing sources of fragility for the country (Annex III. Country Engagement Strategy). The exceptional spending on the hosting of the Pacific Games and preparation for the general elections should be tightly controlled, to avoid risks of slippages and cost overruns crowding out other essential expenditures, including on targeted support for the vulnerable and investment for future growth. The authorities should carefully formulate a utilization and maintenance plan for facilities built for the Pacific Games. The authorities should also closely coordinate with development partners, including through accelerating reforms required for their budget support, to secure financing necessary for implementing the budget and avoiding payment arrears.

16. Rebuilding the cash balance is a priority once the recovery is ensured. While the DSA indicates moderate risk of debt distress with substantial space to absorb shocks, the country faces significant liquidity risks and vulnerabilities to exogenous shocks, including natural disasters.[5] Once the recovery is firmly underway, the authorities should commence gradual fiscal adjustment to rebuild the broad cash balance to at least two months of total spending to reduce liquidity risks. Shifting the composition of expenditures away from inefficient and non-transparent spending, including on the Constituency Development Funds (CDFs)[6], and enhancing the efficiency of spending on health and education[7] would be priorities on the expenditure side. In case the recovery falters or the economy is hit by adverse shocks, the authorities will need to address liquidity risks through careful cash management and more intensive expenditure control, and by seeking additional donor assistance.

17. Public investment mobilization remains a priority. Solomon Islands lags its peers in terms of access to infrastructure and public services (Annex III. Country Engagement Strategy). Staff estimates that the country would need additional spending of about 6.9 percent of 2030 GDP every year, to meet the Sustainable Development Goals (SDGs) on health, education, and infrastructure while building climate resilience.[8] Therefore, mobilizing public investment in physical and human capital, in particular for enhancing climate resilience, should be a fiscal priority following the

Access to Services and Infrastructure



Source: Sustainable Development Report 2022

rebuilding of the cash balance. The authorities' actions to benefit from multilateral climate funds including the establishment of the Climate Finance Steering Committee are welcome in this respect,

[5] Staff's work shows that there is a probability of around 13.5 percent of a disaster each year of a magnitude of more than 3 percent of GDP or impacting 5 percent of the population (IMF, "The Economic Impact of Natural Disaster in Pacific Island Countries," IMF Working Paper 18/108).

[6] The funds are allocated to each of the 50 Parliament Members to be spent in their constituencies at their discretion, with limited accountability and alignment with the government's development priorities. The Funds accounted for 36 percent of the total development expenditure in 2021.

[7] Specific policies include the restructuring of tertiary scholarships and better integration of off-budget health spending financed by donors into the budget.

[8] IMF, "Spending needs for Achieving SDGs with Climate Resilience," Selected Issues Paper for Solomon Islands, 2021.

although multi-faceted efforts to improve institutional capacities and governance mechanisms are needed to access the funds.

18. Institutional frameworks for managing projects should be further strengthened. Solomon Islands is expected to continuously benefit from sizeable concessional financing from donors for infrastructure projects over the next five years. However, the country would increasingly rely on more expensive and shorter-maturity domestic financing, as expressed in the Medium-term Debt Management Strategy, since budgetary grants and concessional borrowing are projected to subside over time. This shift would significantly increase the debt service costs and bring about serious risks in debt management, highlighting the critical importance of public investment management—projects need to be appropriately planned, prioritized, phased, and implemented so that they will not crowd out private investment, undermine economic and financial stability, and jeopardize fiscal and external sustainability. Financing arrangements accompanying the projects should be carefully negotiated. Strengthening public investment management, including through establishing a centralized appraisal procedure, increasing maintenance spending, and improving coordination with donors will be critical for the country to benefit from the large pipeline of public investments over the long run.

19. Efforts to strengthen domestic revenue mobilization should continue. While Solomon Islands stands comparable to its neighbors in terms of the tax-revenue-to-GDP ratio, it is suffering from revenue losses caused by the fragmented tax systems: multiple indirect taxes are charged on goods and services under separate legislations, different tax rules with arbitrary exemptions, and overlapping tax bases and obligations. The adoption of the Tax Administration Act in September 2022 is welcome, and its successful implementation will help raise significant revenues through improving the efficiency, consistency, and compliance of tax administration. Undertaking a Tax Administration Diagnostic Assessment Tool (TADAT) assessment would provide a useful roadmap for further tax administration reforms. Introduction of a Value Added Tax (VAT), currently being prepared within the government with help from development partners, is expected to consolidate the fragmented tax systems and yield additional revenues from efficiency gains over the medium term.[9] As the authorities are aiming at developing a Medium-Term Revenue Strategy (MTRS) in the coming years, the near-term focus should be on strengthening the budgetary process to develop the necessary capacity. The Fund continues to support the authorities' tax reforms, including to develop fiscal regimes for mineral exports. Ensuring adequate resources for revenue authorities is needed to advance reforms.

20. Strengthening fiscal governance and transparency remains essential. Staff welcomes the publication of audit results of COVID-19 related expenditures on the Office of the Auditor General

[9] Staff estimates that fragile countries in the Pacific including Solomon Islands could mobilize additional tax revenue of around 4 percent of GDP through implementing key tax policy and revenue administration reforms (IMF, "Funding the Future: Tax Revenue Mobilization in the Pacific Island Countries," Departmental paper, 2022).

(OAG)'s website[10], while the work to document crisis-related public procurement continues. Other immediate priorities include finalizing regulations under the Public Financial Management Act and improving liquidity forecasting, cash management, and expenditure control to prevent payment arrears. Improving the budgetary process and reporting, including more realistic budget envelopes, consistent classification of spending, and gradual integration of donor spending[11], would enhance reliability and accountability of budget. Reviewing the CDF Act and establishing regulations to strengthen planning, reporting, monitoring, and governance of the funds' operation is critically important to ensure that the funds are used effectively and transparently in a manner that is consistent with the National Development Strategy.

Authorities' Views

21. The authorities concurred with staff's views on increasing future fiscal challenges. They plan to address the challenges through revenue-enhancing measures and tight expenditure control, while striving to secure domestic financing and donor support. The authorities intend to put in place measures to reduce the deficit and rebuild the cash balance in the interim budget for 2024 and committed to prudent management of infrastructure projects and assessment of the terms of external borrowing so as not to undermine macroeconomic stability and debt sustainability. They see tax reform for domestic revenue mobilization as a priority, including the introduction of a VAT, improvement of a taxation mechanism for mineral exports, and establishment of an MTRS over the medium term, with the help of IMF technical assistance. Documentation of crisis-related public procurement and the CDF Act review are still ongoing, reflecting capacity constraints.

B. Monetary and Exchange Rate Policy

22. IMF staff recommends that the CBSI phase out accommodative measures introduced in response to the pandemic. In light of the expected increase in economic activity driven by the Pacific Games, projected inflation, and the sound financial sector, it is appropriate for the CBSI to raise the Cash Reserve Requirement back to the pre-pandemic level (7.5 percent) with an increased stock of the central bank bills in coming months. It should be done while carefully monitoring economic developments and noting the weak monetary transmission mechanisms, so that the tightening will not undermine the recovery. Further purchases of government securities at the secondary market should be avoided to safeguard macroeconomic stability and independence of the central bank.[12] The CBSI should continue efforts to build its capacity for better implementation of monetary policy, including improving economic analysis and forecasting capabilities and

[10] https://www.oag.gov.sb/press-releases/101-auditor-general-calls-for-strengthening-of-procurement-processes-in-light-of-covid19-audits.html. The report points out a lack of transparency and required documentation in procurement processes for COVID-19 related expenses, providing recommendations to address the findings.

[11] The World Bank estimates that potentially around 90 percent of total donor spending was off budget in 2019, fragmenting the implementation of development policies (World Bank, "Solomon Islands Public Expenditure Review," 2022).

[12] The CBSI purchased a SI$60 million government bond from the Solomon Islands National Provident Fund in December 2020, as part of its measures to address the pandemic.

strengthening the monetary policy communication strategy.

23. The current exchange rate regime remains appropriate, but the weights of the currency basket need to be reviewed to prevent exchange rate misalignment. The Solomon Islands dollar is anchored by a basket of trade partners' currencies and estimated to have appreciated by around 10 percent in real effective terms in 2022, reflecting the strong appreciation of the US dollar against other currencies. The current exchange rate regime remains appropriate helping the authorities maintain a stable macroeconomic environment and contain imported inflation. However, Solomon Islands' external position in 2022 is assessed to be substantially weaker than the level consistent with medium-term fundamentals and desirable policies on the back of the overvalued real exchange rate (Annex II. External Sector Assessment). While other policies will need to adjust to restore balance, notably on the fiscal side, this assessment highlights the necessity of reviewing the weights of the currency basket to ensure that the currency composition and weights of the basket appropriately reflect the country's current trade structure. The weights have remained unchanged for more than a decade and are the highest for the US dollar, even though China has become the country's main trade partner during the period. The IMF stands ready to provide necessary technical assistance for the CBSI.

Authorities' Views

24. The authorities have tightened its monetary policy and agreed on the need for reviewing the weights of the currency basket. The Board of the CBSI decided to raise the Cash Reserve Requirement from 5 percent to 6 percent in March 2023, with a view to containing inflationary pressures while being vigilant about economic recovery. The CBSI does not expect further government bond purchases, although it did not rule out a possibility of taking measures to stabilize the market under exceptional circumstances. The authorities, while viewing the current exchange rate regime as appropriate, requested IMF technical assistance to help review its currency basket to prevent exchange rate misalignment.

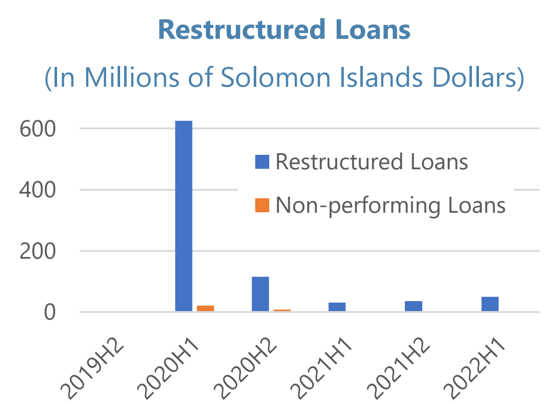
C. Financial Sector Policy

25. The financial sector appears well capitalized and profitable, enhancing its resilience including against a higher global interest rate environment. Commercial banks maintained business operations under mobility restrictions during the first half of 2022 and supported the economy including through restructuring loans (Box 2). Their capital adequacy ratio stood at 32.9 percent at end-2022, well over the regulatory requirement of 15 percent, and their return on assets and equity improved. The ratio of non-performing loans to gross loans declined to 9.4 percent at end-2022, from its recent peak of 11.8 percent in June 2020. The Solomon Islands National Provident Fund (SINPF), the sole superannuation in the country, recorded improved capital and profitability in 2022. The Development Bank of Solomon Islands (DBSI) is expanding its lending with emphasis on small and medium sized enterprises and the tourism and agricultural sectors. While the DBSI's increasing lending activity has improved its profitability, effective supervision of the development bank reflecting its business and funding model remains a challenge for the CBSI.

Box 2. Role of the Banking Sector in Weathering Impacts of COVID-19

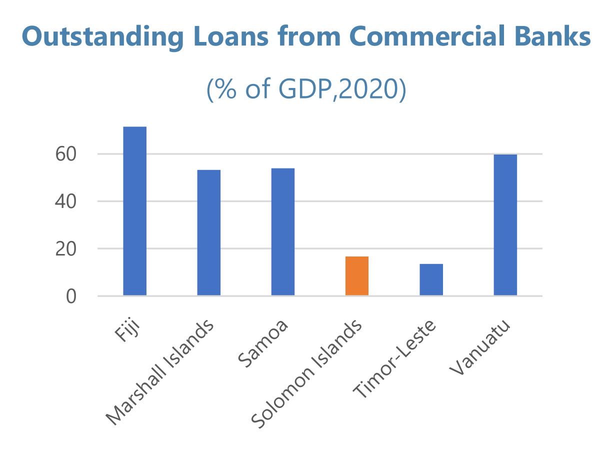
The CBSI responded to the global spreading of COVID-19 promptly by taking regulatory measures. It introduced a temporary waiver of loan loss provisions in February 2020 to allow banks to restructure loans of creditors that were hard hit by the pandemic. The measures expired in August 2022 after several extensions and an interruption, in line with the reopening of the economy.

The banking sector supported the economy while maintaining financial soundness. A total of 699 loans were restructured by all the commercial banks and credit institutions licensed in Solomon Islands from 2019H2 to 2022H1, amounting to SI$856.9 million (6 percent of GDP). Around three quarters of the restructuring took place during 2020H1, reflecting uncertainties surrounding credit risks at that time. Restructured loans declined steadily since then, with only 6 percent of the total restructuring conducted in 2022H1, despite the riot at end-2021 and the entry of the virus in early 2022. Only 3 percent of the loans restructured were classified as non-performing loans.



Source: Central Bank of Solomon Islands.

26. Reforms to support financial sector development and inclusion should continue. Commercial banks' credit to the private sector remains subdued in Solomon Islands compared to regional peers, with high excess reserves and lending rates. There is no immediate solution to it, as the country's dispersed terrain and low population density pose significant constraints on financial sector development and inclusion (Annex III. Country Engagement Strategy). Reforms to reduce asymmetric information, facilitate enforcement of contracts, and promote digital financial services could help spur credit growth. Updating legal and regulatory frameworks for the credit union and insurance sectors is also a priority. Staff welcomes the enactment of the National Payment Systems Act 2022, which provides the legal basis for introduction of an electronic payments and settlement system, a key step toward increased access to affordable, efficient, and resilient digital payment services. It is necessary to improve the CBSI's supervisory capacity, including with regard to the DBSI and stress testing of financial institutions.



Source: IMF, Financial Access Survey.

27. Effective AML/CFT implementation should continue to be a priority. Correspondent banking relationship pressures have been relatively muted in Solomon Islands so far, in part because most commercial banks are subsidiaries of foreign banks. The authorities are taking initiatives to support banks and remittance service providers by addressing correspondent banking relationship pressures (e.g., SIM registration measures), although hurdles such as building an adequate know-your-customer (KYC) framework remain to be addressed. In addition, a new AML/CFT legal framework that is consistent with the Financial Action Task Force (FATF) standards and addresses shortcomings identified in the 2019 Mutual Evaluation Report remains to be legislated to reduce financial integrity risks. Clarifying supervisory responsibilities among the agencies and enhancing risk-based supervisory capacities are also needed. The Fund continues to support the authorities' efforts to update the legal framework and enhance supervisory capacities.

Authorities' Views

28. The authorities agreed with the need to promote financial sector development and strengthen the AML/CFT framework. The authorities noted that competition among banks had increased, as reflected in the declining trend of their lending rates (Figure 3), driven by the entry of a new credit institution owned by the SINPF into the market. The CBSI keeps working on updating legal and supervisory frameworks for financial institutions, as well as developing regulations and policies to implement the National Payment Systems Act and promote digital payment services. The CBSI has made efforts to raise awareness of AML/CFT risks and improve compliance of financial institutions and relevant private entities, while continuously working on adopting a new legal framework and improving supervisory capacity for AML/CFT, including through IMF technical assistance.

D. Structural Reforms

29. Reforms to address structural bottlenecks, including governance weaknesses and corruption vulnerabilities, are needed to tackle the pressing challenge of developing new growth drivers and diversifying exports. The projected weakness of the external sector highlights the needs for policy actions to enhance the competitiveness of the economy. The mining (gold, nickel, and bauxite)[13], fisheries, agriculture, and tourism sectors have potential as growth sectors, as discussed in the past Article IV Consultations. While private investment, including FDI in these sectors, needs to complement public investment, frequent land disputes and ineffective dispute resolution mechanisms remain obstacles. Increasing resources for anti-corruption and auditing institutions is essential to advancing reforms to limit corruption and enhance accountability of public spending.

30. Enhancing natural resource wealth management is a priority. The authorities should establish a strong governance framework for the mining sector in which: roles and powers of the authorities are clearly defined; access to land is transparently negotiated and managed; interests of

[13] The World Bank estimates that gold production could add 5 percent to Solomon Islands' GDP, while nickel mining projects could increase GDP by 6 percent in the medium term (World Bank, "Solomon Islands Public Expenditure Review," 2022).

communities including women are inclusively represented; mining operations are adequately monitored to enforce compliance with standards; and revenues from mining are properly generated and transparently managed. Finalizing a Mining Act and rejoining the Extractive Industries Transparency Initiative (EITI) are key steps to enable all Solomon Islanders to benefit from the country's natural resources.

Authorities' Views

31. **The authorities agreed that developing new growth drivers and diversifying exports is an urgent priority.** The government has adopted policies to enhance productivity and competitiveness of the agriculture, fisheries, and tourism sectors, as well as to strengthen the governance of and the licensing standards for the mining sector. The authorities recognize that the issues of land registration and ineffective dispute resolution mechanisms need to be addressed to promote private sector development, while noting that their resolution takes time as current practices are deeply rooted in the culture and tradition of the society. The authorities remain committed to addressing governance vulnerabilities, including through strengthening independence and capacity of anti-corruption and auditing institutions, while considering that concerted efforts including the private sector are needed to overcome the vulnerabilities.

CAPACITY DEVELOPMENT

32. **Capacity development (CD) by the IMF has re-accelerated since the reopening of the border.** CD is more effective with in-person communication and hands-on training provided by staff, including through the Pacific Financial Technical Assistance Center (PFTAC). Recent CD activities include revenue administration; mineral royalties; macroeconomic analysis and forecast; financial sector supervision; macroeconomic statistics; and governance and transparency. These activities are well aligned with policy priorities identified in the IMF's surveillance process and intend to address the sources of fragility, by helping the authorities in maintaining a stable macroeconomic environment and strengthening fiscal governance and transparency (Annex III. Country Engagement Strategy).

33. **IMF CD should remain focused on strengthening sound macroeconomic policy implementation (Annex III. Country Engagement Strategy).** Emerging CD needs include the reporting and auditing of public spending, the management of public investment, review of the exchange rate basket, and the central bank's internal audit as recommended by the safeguards assessment mission[14]. The IMF's CD could support the authorities to develop medium-term frameworks including on fiscal policy, revenue mobilization, and green PFM, but only over the

[14] An update safeguards assessment of the CBSI was completed in July 2022. The assessment found that the external audits and financial reporting framework continue to be broadly aligned with international standards, and the CBSI's organic law provides an adequate legal underpinning for its autonomy. However, substantial effort is required to modernize the internal audit function and to enhance the audit committee's oversight. Since the assessment, the CBSI has been advancing the implementation of several recommendations with IMF technical assistance, such as on internal audit and risk management.

medium term after they build up sufficient capacity. Role-sharing and synergies with development partners should be further explored, such as with the World Bank for fiscal management, the ADB for tax policy, and the United Nations Development Program for anti-corruption and money laundering.

Authorities' Views

34. The authorities agreed on proposed CD priorities and requested further support for compiling economic statistics. The authorities appreciate IMF's CD activities that properly reflect their demand and priorities. In addition to CD priorities proposed by staff, the authorities emphasized the need for enhancing capacity of the National Statistics Office and relevant agencies in compiling statistics such as the national accounts, government financial statistics, consumer price index, and household and labor force surveys.

STAFF APPRAISAL

35. The economy is recovering from multiple shocks in the past three years, but the recovery is still fragile. The reopening of the border and infrastructure spending ahead of the 2023 Pacific Games have accelerated the recovery from civil unrest and the local outbreak of COVID-19, but rising living and business costs have been a drag. The economy remains subject to downside risks, including a potential resurgence of the COVID-19 pandemic, natural disasters, increases in global commodity prices, and recurrent political instability. Both fiscal and current account deficits are expected to persist in the medium-term, driven by large spending on infrastructure, other tangible and human capital development, and declining log exports. Reserve coverage is expected to decline as a result, although it is forecast to remain within the adequacy range under the baseline.

36. Near-term fiscal policy should focus on prudent execution of the 2023 budget, followed by rebuilding of the government's cash balance. Expenditures related to the Pacific Games and the general elections need to be well controlled to minimize the risk of crowding out of other essential spending, including targeted support for the vulnerable and other investment for future growth. IMF staff welcomes the publication of the results of audits of COVID-19 related expenditures and recommends that the OAG also audit expenditures related to the Pacific Games and publish the results. Once the recovery is secured after the Pacific Games, rebuilding the government's broad cash balance to at least two months of total spending should be prioritized.

37. Prudent management of public investment projects including their financing arrangements is an urgent priority. Public investment projects need to be phased in line with the economy's absorptive capacity and accompanying financing arrangements should be carefully negotiated, to mitigate fiscal risks and ensure external balance and debt sustainability. Reforms to improve the quality and accountability of public expenditure, including through improving PFM and reviewing the CDF Act, need to be accelerated. Significant revenues could be mobilized through the completion of the tax administration modernization project and the planned introduction of a VAT.

38. Staff welcomes the recent decision by the CBSI to tighten the monetary policy stance, which underscores its readiness to address inflation while paying due attention to economic growth. The CBSI should stand ready to further adjust its policy stance in case inflationary pressures persisted. It should also avoid additional purchases of government bonds, to safeguard macroeconomic stability and the independence of the central bank. The central bank is encouraged to continue its efforts to improve capacity, including for economic analysis and forecasting, monetary policy communication, and the internal audit function.

39. The current exchange rate regime remains appropriate, but a timely review of the currency basket is called for, given changes in trade patterns. Solomon Islands' external position in 2022 is assessed to be substantially weaker than the level consistent with medium-term fundamentals and desirable policies. While other policies will need to adjust to restore balance, notably on the fiscal side, maintaining external competitiveness will also be critical, especially given that Solomon Islands' trade structure has changed materially over the past decade.

40. Increasing bank lending and enhancing financial integrity remains a challenge. Reforms to moderate credit risks for commercial banks such as reducing asymmetric information and facilitating enforcement of contracts, as well as to promote digital financial services, could spur credit growth. Strengthening legal and supervisory frameworks for AML/CFT and raising awareness of the risks are essential for ensuring integrity of Solomon Islands' financial systems.

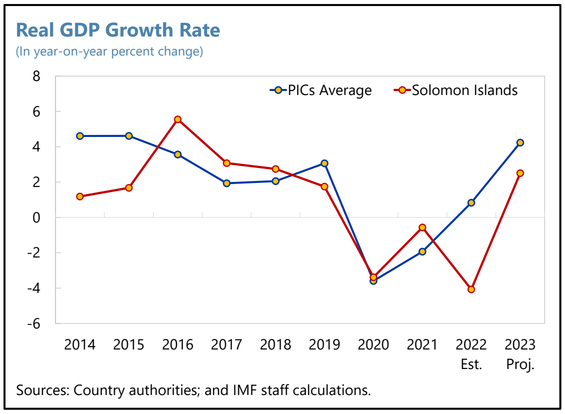
41. Developing new growth drivers, including by enhancing natural resource wealth management, market regulation, and addressing governance weaknesses and corruption vulnerabilities, is an urgent priority. Frequent land disputes and ineffective dispute resolution mechanisms remain long-standing obstacles to private sector development. Strengthening governance and fiscal frameworks for the mining sector including through legislation and rejoining the EITI is needed to utilize the country's rich natural resources in a sustainable and inclusive manner. Progress in governance reforms and anti-corruption efforts would be further supported by strengthening the independence and capacity of anti-corruption institutions and by strengthening the OAG by amending its legal framework consistent with IMF technical assistance recommendations.

42. The IMF continues to support capacity development of the authorities in collaboration with development partners. Immediate CD priorities include the reporting and auditing of public spending; public investment management; review of the exchange rate basket; the central bank's internal audit; and economic statistics such as the national accounts, government financial statistics, and household and labor force surveys.

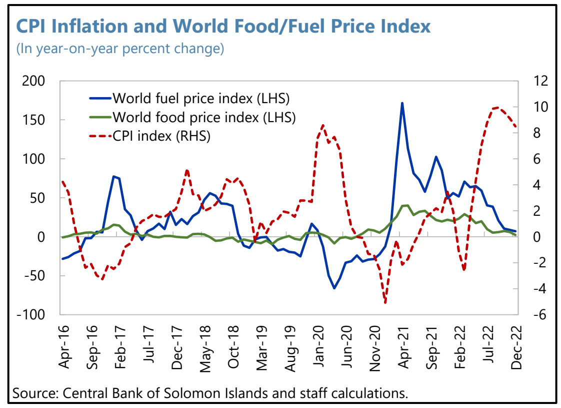
43. It is proposed that the next Article IV consultation takes place on the standard 12-month cycle.

Figure 1. Solomon Islands: Macroeconomic Developments and Outlook

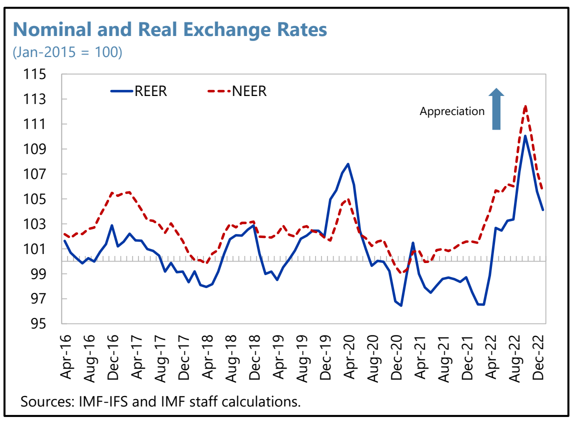
The recovery is lagging compared to neighboring countries, reflecting 2021 social unrest and a late local outbreak of COVID-19.



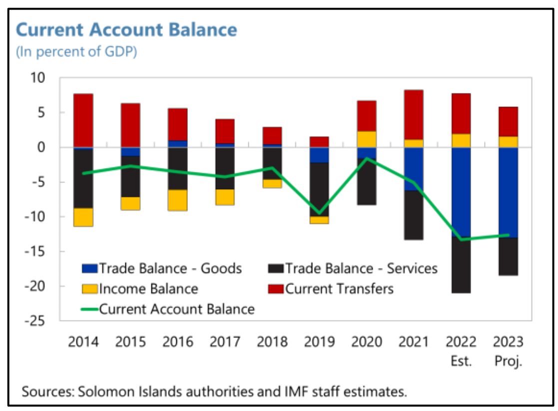
Inflation significantly accelerated in 2022, driven by higher commodity prices following Russia's war in Ukraine.



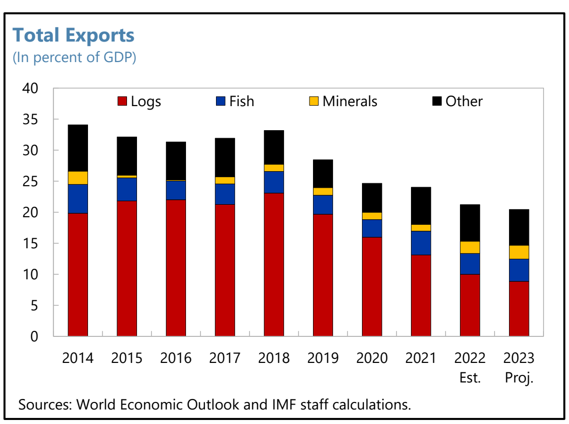
The exchange rate has appreciated…



…while the current account deficit is expected to remain sizeable….



…as logging exports have peaked….



…and imports are expected to increase due to higher import prices and imports related to infrastructure projects.

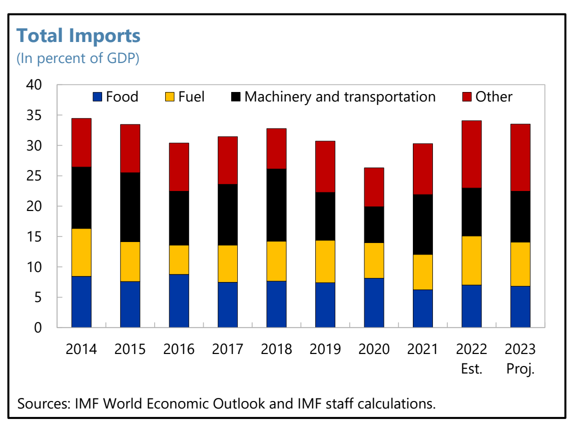
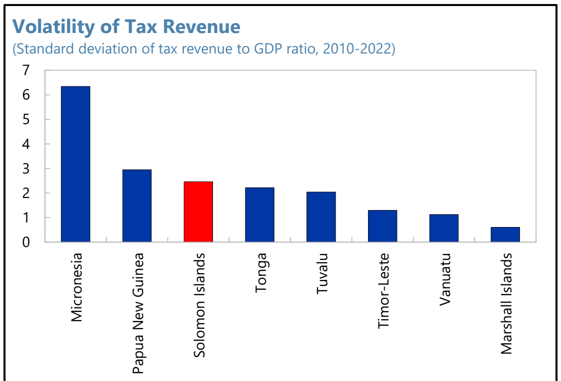


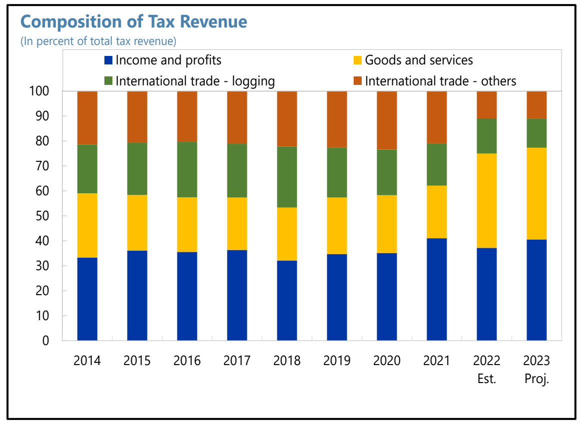
Figure 2. Solomon Islands: Fiscal Indicators

Solomon Islands tax revenue is relatively volatile…

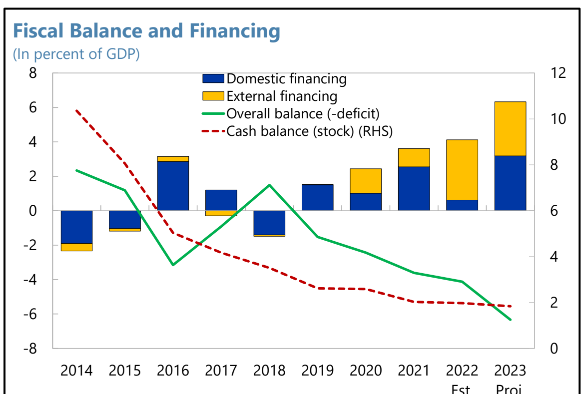


Sources: IMF World Economic Outlook and IMF staff calculations.

… while logging revenue is declining.

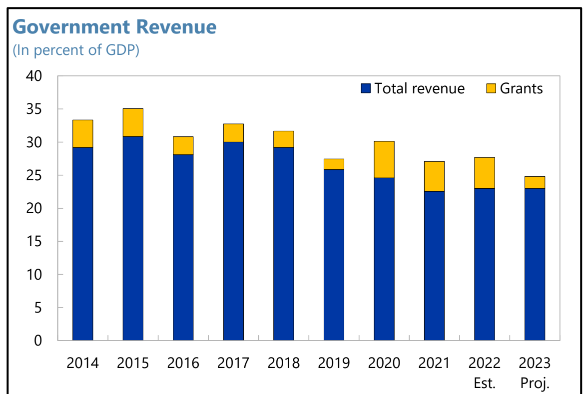


The fiscal deficit has increased and the cash balance has declined,…



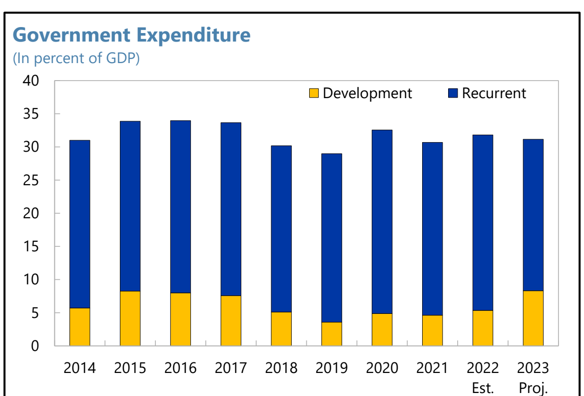
Source: IMF staff calculations.

…as revenue has fallen due to the pandemic and declining production in the logging sector…



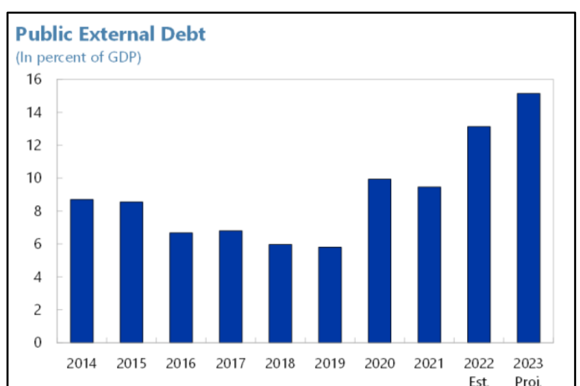
Sources: IMF staff estimates.

…and expenditure is projected to increase because of the Pacific Games and infrastructure projects…



Sources: IMF staff estimates.

…leading to continued increases in the public debt ratio.

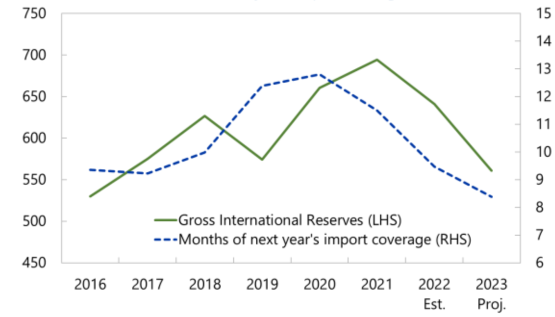


Sources: IMF World Economic Outlook and IMF staff calculations.

Figure 3. Solomon Islands: Money and Credit Developments

Reserve coverage has decreased but has remained at comfortable levels.

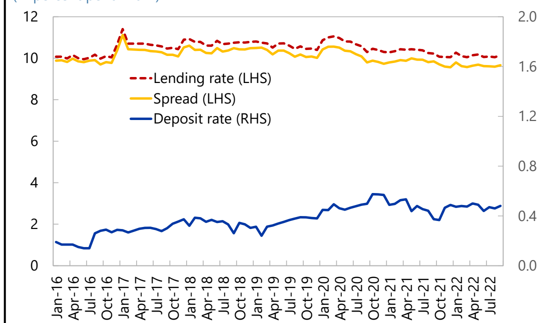
Gross International Reserves
(In millions of USD; in months of next year's import coverage (RHS))



Sources: CBSI and IMF staff calculations.

Banking sector spreads are slowly declining but remain very high.

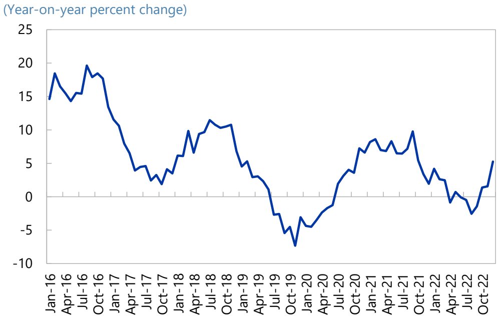
Lending and Deposit Rates
(In percent per annum)



Sources: IMF-IFS, Central Bank of Solomon Islands, and IMF staff calculations.

Broad money growth is slowing…

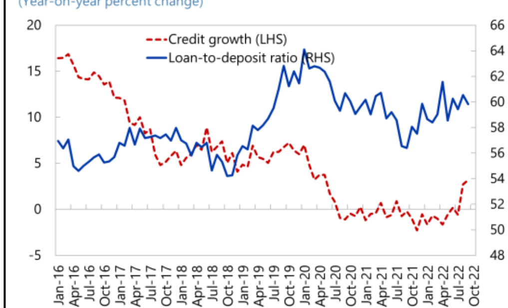
Broad Money
(Year-on-year percent change)



Sources: IMF-IFS and IMF staff calculations.

…while credit growth has shown some pickup as the economy reopens.

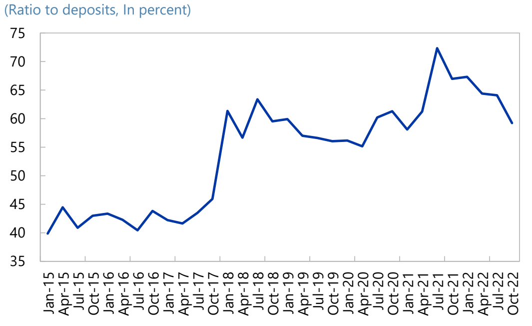
Credit Growth
(Year-on-year percent change)



Sources: IMF-IFS and IMF staff calculations.

Bank excess reserves remain high…

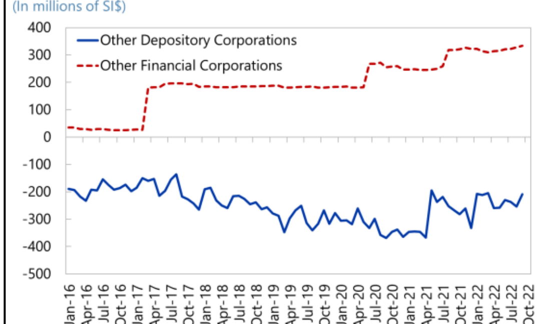
Bank Reserves
(Ratio to deposits, In percent)



Sources: IMF-IFS and IMF staff calculations.

…and credit to the central government has increased as the government has issued domestic bonds.

Net Credit to Central Government
(In millions of SI$)



Sources: CBSI and IMF staff calculations.

Table 1. Solomon Islands: Selected Economic Indicators, 2018–2027

Per capita GDP (2022): US$2,265

Population (2020): 686,878

Quota: SDR 20.8 million

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
					Est.			Proj.		
GROWTH AND PRICES	Annual percentage change unless otherwise indicated									
Real GDP	2.7	1.7	-3.4	-0.6	-4.1	2.5	2.4	3.0	3.0	3.0
CPI (period average)	3.5	1.6	3.0	-0.1	5.5	4.8	3.7	3.3	3.3	3.3
CPI (end of period)	3.8	2.7	-2.5	3.5	8.5	4.2	3.3	3.3	3.3	3.3
GDP deflator	7.9	1.2	-1.3	1.1	7.0	4.7	3.4	3.4	3.2	3.2
Nominal GDP (in SI$ millions)	12,847	13,234	12,617	12,690	13,021	13,980	14,807	15,772	16,761	17,826
CENTRAL GOVERNMENT OPERATIONS	In percent of GDP									
Total revenue and grants	31.7	27.4	30.1	27.1	27.7	24.8	26.4	26.9	26.7	26.6
Revenue	29.2	25.8	24.6	22.6	23.0	23.0	24.3	25.0	24.8	24.7
Grants (budgetary)	2.5	1.6	5.5	4.5	4.7	1.8	2.0	1.9	1.9	1.9
Total expenditure	30.2	29.0	32.6	30.7	31.8	31.1	30.9	30.2	30.0	29.9
Recurrent expenditure	25.1	25.4	27.7	26.1	26.5	22.8	22.7	22.7	22.9	23.1
Development expenditure	5.1	3.6	4.9	4.6	5.4	8.3	8.2	7.5	7.1	6.8
Overall balance	1.5	-1.5	-2.4	-3.6	-4.1	-6.3	-4.5	-3.4	-3.3	-3.3
Foreign financing (net)	-0.1	0.0	1.4	1.1	0.3	2.6	5.8	5.2	3.1	2.9
Domestic financing (net)	-1.4	1.5	1.0	2.6	0.6	3.2	2.8	2.0	3.1	3.1
Central government debt 1/	7.9	7.9	13.5	15.4	16.9	22.2	25.7	27.8	29.3	30.8
MACROFINANCIAL	Annual percentage change (end of year)									
Credit to private sector	4.1	6.1	0.3	-0.4	0.8	2.0	3.5	5.0	5.0	5.0
Broad money	6.8	-3.1	6.6	1.9	5.3	6.3	1.4	1.2	0.9	0.7
Reserve money	10.3	-7.1	23.0	10.6	4.0	2.1	1.4	1.2	0.9	0.7
BALANCE OF PAYMENTS	In US$ millions unless otherwise indicated									
Trade balance (goods and services)	-67.6	-161.6	-127.4	-205.4	-335.1	-313.4	-309.9	-319.2	-299.5	-304.4
(percent of GDP)	-4.2	-10.0	-8.3	-13.3	-21.0	-18.4	-17.2	-16.6	-14.7	-14.0
Current account balance	-47.8	-154.0	-25.1	-78.3	-212.1	-214.9	-183.9	-187.8	-161.1	-156.5
(percent of GDP)	-3.0	-9.5	-1.6	-5.1	-13.3	-12.6	-10.2	-9.8	-7.9	-7.2
Foreign direct investment (+ = decrease)	-15.9	-28.7	-5.7	-23.1	-39.5	-41.9	-44.1	-46.6	-49.2	-51.9
(percent of GDP)	-1.0	-1.8	-0.4	-1.5	-2.5	-2.5	-2.4	-2.4	-2.4	-2.4
Overall balance (+ = decrease)	-57.4	33.8	-73.1	-38.3	5.6	85.2	28.4	48.5	15.4	33.5
Gross official reserves (in US$ millions, end of period) 2/	613.1	574.1	660.6	694.5	641.0	560.7	541.7	498.9	485.5	453.8
(in months of next year's imports of GNFS)	9.8	12.4	12.8	11.5	9.5	8.4	8.0	7.4	7.0	6.3
EXCHANGE RATE (SI$/US$, end of period)	8.1	8.2	8.05	8.10	...	...	...	...	...	...
Real effective exchange rate (end of period, 2010 = 100)	126.9	127.5	129.9	124.8	...	...	...	...	...	...
MEMORANDUM ITEMS:										
General Government Development Spending (in SI$ millions)	963	1,100	696	923	1,483	1,291	1,295	1,320	1,348	1,405
Cash balance (in SI$ millions)	311	206	206	137	137	137	137	137	137	137
in months of recurrent spending	1.3	0.7	0.8	0.5	0.5	0.5	0.4	0.4	0.4	0.4
SIG Deposit Account (In addition to cash balance, in SI$ millions)	140	140	120	120	231	231	231	231	231	231
Broader cash balance (=Cash balance+ SIG Deposit Account; in SI$ millions)	451	346	326	257	367	367	367	367	367	367
in months of total spending 3/	1.5	1.1	1.1	0.8	0.9	0.8	0.7	0.7	0.7	0.6
Public domestic debt, including arrears (in SI$ millions)	2	2	4	6	6	8	11	12	14	16

Sources: Data provided by the authorities; and IMF staff estimates and projections.

1/ Includes disbursements under the IMF-supported programs.

2/ Includes SDR allocations made by the IMF to Solomon Islands in 2009 and in 2021, and actual and prospective disbursements under the IMF-supported programs.

3/ Total spending is defined as total expenditure, excluding grant-funded expenditure.

Table 2a. Solomon Islands: Summary of Fiscal Accounts, 2018–2027
(in millions of Solomon Islands dollars)

	2018 Act	2019 Act.	2020 Act.	2021 Act.	2022 Est.	2023 Proj.	2024 Proj.	2025 Proj.	2026 Proj.	2027 Proj.
Total revenue and grants	4,068	3,633	3,800	3,435	3,604	3,469	3,905	4,240	4,480	4,747
Total revenue	3,751	3,419	3,103	2,863	2,993	3,217	3,605	3,943	4,165	4,412
Tax revenue	3,280	2,942	2,656	2,470	2,688	2,791	3,057	3,362	3,549	3,752
Income and profits	1,038	1,006	918	994	983	916	1,070	1,174	1,246	1,324
Goods and services	689	657	605	511	678	782	978	1,042	1,107	1,177
International trade and transactions	1,511	1,237	1,090	918	980	1,017	954	1,087	1,131	1,181
Of which: Tax on logging	790	581	477	406	357	337	311	301	296	293
Other revenue	471	477	447	393	305	426	547	581	616	660
Of which: Mining revenue	0	0	0	0	15	15	36	38	39	40
Budgetary Grants	317	213	697	572	612	252	301	297	314	335
Expenditure	3,877	3,834	4,108	3,893	4,141	4,354	4,573	4,770	5,031	5,339
Recurrent expenditure	3,221	3,362	3,493	3,307	3,444	3,193	3,361	3,587	3,838	4,125
Compensation of employees	1,322	1,393	1,467	1,461	1,513	1,569	1,643	1,725	1,829	1,938
Interest payments	10	20	25	27	38	68	71	100	124	169
Other recurrent expenditure	1,889	1,949	2,001	1,820	1,893	1,556	1,647	1,762	1,885	2,017
Development expenditure (government funded)	656	473	615	586	697	1,161	1,212	1,182	1,193	1,214
Of which: Constituency Development Funds	320	181	240	340	340	340	390	390	390	390
Current balance 1/	530	58	-390	-444	-452	24	244	356	327	287
Primary balance	202	-181	-283	-431	-498	-817	-596	-429	-427	-423
Overall balance	191	-202	-308	-458	-537	-885	-667	-529	-552	-592
Total financing	-191	202	308	458	537	885	667	529	552	592
Foreign (net)	-10	4	179	134	456	440	256	212	40	35
Domestic (net)	-181	198	129	324	81	445	411	317	511	558
Of which : Change in narrow cash balance (+=decrease)	-33	-104	-1	-69	92	0	0	41	42	43
Change in public domestic debt (+=increase)	53	28	179	296	-11	445	411	276	469	515
Memorandum items:										
Nominal GDP (in SI$ millions)	12,847	13,234	12,617	12,690	13,021	13,980	14,807	15,772	16,761	17,826
General government development expenditure (including offbudget grants) (in SI$ millions)	963	1,100	725	696	923	1,483	1,360	1,291	1,295	1,320
Public domestic debt, including arrears (in SI$ millions)	245	273	452	748	737	1,183	1,593	1,869	2,339	2,854
Narrow cash balance (in SI$ millions) 2/	311	206	206	137	137	137	137	137	137	137
in months of recurrent spending 3/	1.2	0.7	0.7	0.5	0.5	0.5	0.5	0.5	0.4	0.4
SIG Deposit Account and others (in SI$ millions)	140	140	120	120	231	231	231	231	231	231
Broader cash balance (in SI$ millions)	451	346	326	257	367	367	367	367	367	367
in months of total spending 4/	1.4	1.1	1.0	0.8	1.1	1.0	1.0	0.9	0.9	0.8
Accumulated domestic arrears (in SI$ million)	0	0	100	96	71	24	0	0	0	0
Non-commodity primary balance 5/ (in SI$ millions)	-905	-976	-1,457	-1,410	-1,482	-1,421	-1,245	-1,065	-1,076	-1,090

Sources: Data provided by the Solomon Islands authorities; and IMF staff estimates and projections.

1/ Defined as total revenue minus recurrent expenditure.

2/ Defined as the sum of government deposits held at the CBSI and the commercial banks minus unpaid payment orders and unpresented checks. From 2016 onward, deposits held at the CBSI and the commercial banks have used as a proxy for the narrow cash reserve

3/ Recurrent spending is defined as recurrent expenditure, excluding grant-funded recurrent expenditure.

4/ Broader cash balance=Narrow cash balance+ SIG Deposit Account; Total spending is defined as total expenditure, excluding grant-funded expenditure.

5/ Defined as nonmineral nonlogging revenue (excludes grants) minus government-funded spending excluding interest payments.

Table 2b. Solomon Islands: Summary of Fiscal Accounts, 2018–2027
(in percent of GDP)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
	Act	Act.	Act.	Act.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	31.7	27.4	30.1	27.1	27.7	24.8	26.4	26.9	26.7	26.6
Total revenue	29.2	25.8	24.6	22.6	23.0	23.0	24.3	25.0	24.8	24.7
Tax revenue	25.5	22.2	21.1	19.5	20.6	20.0	20.6	21.3	21.2	21.0
Income and profits	8.1	7.6	7.3	7.8	7.5	6.6	7.2	7.4	7.4	7.4
Goods and services	5.4	5.0	4.8	4.0	5.2	5.6	6.6	6.6	6.6	6.6
International trade and transactions	11.8	9.3	8.6	7.2	7.5	7.3	6.4	6.9	6.7	6.6
Of which: Tax on logging	6.1	4.4	3.8	3.2	2.7	2.4	2.1	1.9	1.8	1.6
Other revenue	3.7	3.6	3.5	3.1	2.3	3.0	3.7	3.7	3.7	3.7
Of which: Mining revenue	0.0	0.0	0.0	0.0	0.1	0.1	0.2	0.2	0.2	0.2
Budgetary Grants	2.5	1.6	5.5	4.5	4.7	1.8	2.0	1.9	1.9	1.9
Expenditure	30.2	29.0	32.6	30.7	31.8	31.1	30.9	30.2	30.0	29.9
Recurrent expenditure	25.1	25.4	27.7	26.1	26.5	22.8	22.7	22.7	22.9	23.1
Compensation of employees	10.3	10.5	11.6	11.5	11.6	11.2	11.1	10.9	10.9	10.9
Interest payments	0.1	0.2	0.2	0.2	0.3	0.5	0.5	0.6	0.7	1.0
Other recurrent expenditure	14.7	14.7	15.9	14.3	14.5	11.1	11.1	11.2	11.2	11.3
Development expenditure (government funded)	5.1	3.6	4.9	4.6	5.4	8.3	8.2	7.5	7.1	6.8
Of which: Constituency Development Funds	2.5	1.4	1.9	2.7	2.6	2.4	2.6	2.5	2.3	2.2
Current balance 1/	4.1	0.4	-3.1	-3.5	-3.5	0.2	1.6	2.3	2.0	1.6
Primary balance	1.6	-1.4	-2.2	-3.4	-3.8	-5.8	-4.0	-2.7	-2.6	-2.4
Overall balance	1.5	-1.5	-2.4	-3.6	-4.1	-6.3	-4.5	-3.4	-3.3	-3.3
Total financing	-1.5	1.5	2.4	3.6	4.1	6.3	4.5	3.4	3.3	3.3
Foreign (net)	-0.1	0.0	1.4	1.1	3.5	3.1	1.7	1.3	0.2	0.2
Domestic (net)	-1.4	1.5	1.0	2.6	0.6	3.2	2.8	2.0	3.1	3.1
Of which : Change in narrow cash balance (+=decrease)	-0.3	-0.8	0.0	-0.5	0.7	0.0	0.0	0.3	0.3	0.2
Change in public domestic debt (+=increase)	0.4	0.2	1.4	2.3	-0.1	3.2	2.8	1.8	2.8	2.9
Memorandum items:										
General government development expenditure (including off-budget grants)	7.5	8.3	5.7	5.5	7.1	10.6	9.2	8.2	7.7	7.4
Accumulated domestic arrears (In percent of GDP)	0.0	0.0	0.8	0.8	0.5	0.2	0.0	0.0	0.0	0.0
Public domestic debt, including arrears (In percent of GDP)	1.9	2.1	3.6	5.9	5.7	8.5	10.8	11.9	14.0	16.0
Non-commodity primary balance (In percent of GDP) 2/	-7.0	-7.4	-11.5	-11.1	-11.4	-10.2	-8.4	-6.8	-6.4	-6.1

Sources: Data provided by the Solomon Islands authorities; and IMF staff estimates and projections.

1/ Defined as total revenue minus recurrent expenditure, excluding grant-funded recurrent expenditure.

2/ Defined as nonmineral nonlogging revenue (excludes grants) minus government-funded spending excluding interest payments.

Table 3. Solomon Islands: Balance of Payments, 2018–2027 1/

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
					Est.			Proj.		
	(In millions of U.S. dollars)									
Current account balance	-47.8	-154.0	-25.1	-78.3	-212.1	-214.9	-183.9	-187.8	-161.1	-156.5
Trade balance for goods	6.5	-36.4	-25.3	-97.0	-205.1	-222.1	-203.8	-208.5	-180.3	-176.0
Exports	536.0	460.9	378.7	371.2	338.5	347.8	363.4	365.6	377.6	399.7
Logs	372.9	318.6	245.5	202.7	159.5	150.8	139.2	134.4	132.1	130.9
Fish	56.2	49.6	43.5	59.2	53.5	61.1	61.4	62.2	63.1	71.1
Minerals	19.0	19.8	18.1	16.9	31.5	37.9	56.5	59.7	63.4	67.9
Other	87.9	73.0	71.7	92.4	94.0	98.1	106.2	109.2	118.9	129.7
Imports	529.4	497.3	404.0	468.2	543.6	569.9	567.1	574.1	557.9	575.6
Trade balance for services	-74.1	-125.3	-102.1	-108.3	-130.0	-91.3	-106.2	-110.7	-119.2	-128.4
Exports	144.7	130.4	50.1	42.6	50.8	151.3	129.0	130.0	131.3	132.7
Imports	218.8	255.6	152.2	150.9	180.9	242.7	235.2	240.7	250.5	261.1
Income balance	-20.4	-16.4	35.8	17.4	30.7	26.3	27.7	29.9	27.2	29.0
Credits	42.5	49.9	56.6	54.3	80.3	64.1	70.8	74.9	75.7	80.0
Debits	63.0	66.3	20.8	36.9	49.6	37.7	43.0	45.0	48.5	51.0
Current transfers balance	40.2	24.0	66.5	109.7	92.3	72.3	98.3	101.4	111.2	118.8
Of which: Official transfers, net	50.5	54.3	71.3	98.8	83.5	39.0	43.5	37.4	41.4	37.5
Capital account balance	60.0	63.6	62.3	65.7	137.6	73.2	73.2	74.3	76.7	79.3
Credits	60.0	63.6	62.3	65.7	137.6	73.2	73.2	74.3	76.7	79.3
Debit	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account balance (excludes reserve assets)	-17.6	-20.4	-7.2	-88.7	-68.9	-56.5	-82.4	-65.1	-69.0	-43.8
Direct investment balance	-15.9	-28.7	-5.7	-23.1	-39.5	-41.9	-44.1	-46.6	-49.2	-51.9
Outwards	9.1	4.0	3.3	4.8	4.1	5.1	5.2	5.4	5.7	5.9
Inwards	25.0	32.8	9.0	27.9	43.6	47.0	49.4	52.1	54.8	57.8
Portfolio investment balance	-0.2	3.9	1.5	6.1	3.9	4.2	4.4	4.7	5.0	5.4
Other investment balance	-1.5	4.5	-3.0	-71.7	-33.3	-18.8	-42.7	-23.2	-24.8	2.8
Assets	6.0	-1.1	10.7	2.8	15.5	5.4	9.0	9.6	8.9	8.4
Of which: Amortization of official loans	-6.9	-7.0	5.6	5.4	5.2	5.5	6.2	8.7	8.1	7.8
Liabilities	7.5	-5.5	13.6	74.4	48.8	24.2	51.7	32.8	33.7	5.6
Of which: disbursement of official loans (incl. SDR)	9.0	7.6	56.2	23.9	61.8	34.2	61.5	42.8	43.7	16.2
Errors and omissions	27.5	36.2	28.6	-37.7	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-57.4	33.8	-73.1	-38.3	5.6	85.2	28.4	48.5	15.4	33.5
Financing	-57.4	33.8	-73.1	-38.3	5.6	85.2	28.4	48.5	15.4	33.5
Change in gross reserves (- = increase)	-60.8	31.7	-44.3	-38.3	5.6	80.3	19.0	42.8	13.5	31.6
Net use of IMF Credit	-3.5	-2.1	28.8	0.0	0.0	-4.9	-9.5	-5.7	-1.9	-1.9
Of which: IMF Disbursements 2/	0.0	0.0	29.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which: Repayments to the IMF	-3.5	-2.1	-0.2	0.0	0.0	-4.9	-9.5	-5.7	-1.9	-1.9
Other Financing (net of IMF credit) 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	(In percent of GDP, unless otherwise indicated)									
Current account	-3.0	-9.5	-1.6	-5.1	-13.3	-12.6	-10.2	-9.8	-7.9	-7.2
Trade balance for goods	0.4	-2.2	-1.6	-6.3	-12.9	-13.1	-11.3	-10.9	-8.8	-8.1
Exports	33.2	28.5	24.7	24.0	21.2	20.5	20.2	19.1	18.5	18.4
Imports	32.8	30.7	26.3	30.3	34.1	33.5	31.5	29.9	27.4	26.5
Trade balance for services	-4.6	-7.7	-6.6	-7.0	-8.1	-5.4	-5.9	-5.8	-5.8	-5.9
Income balance	-1.3	-1.0	2.3	1.1	1.9	1.5	1.5	1.6	1.3	1.3
Current transfers balance	2.5	1.5	4.3	7.1	5.8	4.2	5.5	5.3	5.5	5.5
Of which: Official transfers net	3.1	3.4	4.6	6.4	5.2	2.3	2.4	2.0	2.0	1.7
Capital account balance	3.7	3.9	4.1	4.3	8.6	4.3	4.1	3.9	3.8	3.7
Direct investment balance	-1.0	-1.8	-0.4	-1.5	-2.5	-2.5	-2.4	-2.4	-2.4	-2.4
Of which: Inward FDI	1.5	2.0	0.6	1.8	2.7	2.8	2.7	2.7	2.7	2.7
Other investment balance	-0.1	0.3	-0.2	-4.6	-2.1	-1.1	-2.4	-1.2	-1.2	0.1
Memorandum items										
Gross official foreign reserves (in US$ million) 3/	613.1	574.1	660.6	694.5	641.0	560.7	541.7	498.9	485.5	453.8
In months of next year's imports of GNFS	9.8	12.4	12.8	11.5	9.5	8.4	8.0	7.4	7.0	6.3
Gross external public debt (in percent of GDP)	5.8	5.8	8.3	9.8	11.3	13.9	15.0	15.9	15.4	14.8
Disbursement of concessional borrowing (in US$ millions)	5.6	16.5	86.4	97.4	65.7	51.2	46.9	44.6	44.6	44.6
External public debt service (in percent of exports of GNFS)	1.1	1.4	1.6	1.6	1.7	1.4	1.8	2.4	2.4	2.5
Nominal GDP (in US$ millions)	1,615.5	1,619.2	1,536.1	1,545.0	1,595.7	1,700.7	1,801.4	1,918.7	2,039.1	2,168.6

Sources: Data provided by the Solomon Islands authorities; and IMF staff estimates and projections.

1/ The presentation follows the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6)

2/ Includes 100 percent of Fund quota of which 1/3 as RCF and 2/3 as RFI.

3/ Includes SDR allocations made by the IMF to Solomon Islands in 2009 and in 2021, and actual and prospective disbursements under the IMF-supported programs.

Table 4. Solomon Islands: Summary Accounts of the Banking System, 2018–2024 1/

	2018	2019	2020	2021	2022	2023	2024
					Est.	Proj.	
	(In millions of Solomon Islands dollars, end of period)						
Central Bank of Solomon Islands (CBSI)							
Net foreign assets (NFA)	4,834	4,580	4,949	5,039	4,860	4,045	3,889
Net international reserves (NIR)	4,957	4,696	4,662	4,636	5,190	4,375	4,220
Other NFA	-123	-115	287	403	-330	-330	-330
Net domestic assets (NDA)	-977	-933	-982	-1,153	-928	-28	185
Net claims on central government	-1,026	-860	-784	-616	-337	-337	-337
Claims	5	6	65	186	185	185	185
Deposits	1,032	866	850	802	523	523	523
Other items (net)	136	172	182	165	147	147	147
Reserve money	3,070	2,852	3,509	3,880	4,036	4,121	4,179
Currency in circulation	908	910	1,095	1,247	1,279	1,373	1,454
Bank deposits	2,158	1,934	2,409	2,626	2,755	2,746	2,722
Other deposits	4	8	5	6	2	2	3
Other depository corporations							
NFA of commercial banks	218	201	364	179	295	304	313
Assets	439	427	504	524	603	612	622
Liabilities	221	226	140	344	309	309	309
NDA of commercial banks	1,169	1,234	1,088	1,458	1,587	1,861	1,881
Net claims on central government	-257	-277	-364	-332	-217	-242	-308
Claims	25	33	45	91	98	73	7
Deposits	282	310	408	423	315	315	315
Claims on the private sector	2,460	2,607	2,613	2,599	2,619	2,672	2,765
Other items (net)	-1,034	-1,097	-1,162	-809	-815	-568	-577
Reserves and vault cash	2,238	2,017	2,479	2,704	2,846	2,909	2,894
Deposits	3,625	3,451	3,930	4,343	4,411	4,509	4,584
Depository corporations survey							
NFA of the banking system	5,053	4,781	5,312	5,219	5,155	4,349	4,202
Central bank	4,834	4,580	4,949	5,039	4,860	4,045	3,889
Other depository corporations	218	201	364	179	295	304	313
NDA of the banking system	192	301	106	305	659	1,833	2,066
Net claims on central government	-1,283	-1,137	-1,148	-948	-555	-580	-645
Claims on the private sector 2/	2,469	2,621	2,629	2,619	2,641	2,693	2,787
Other items (net)	-994	-1,183	-1,375	-1,366	-1,427	-281	-75
Broad money (M3)	5,244	5,082	5,418	5,524	5,814	6,182	6,268
M1	3,936	3,848	4,334	4,426	4,746	5,103	5,174
Currency outside banks	828	828	1,025	1,170	1,188	1,210	1,282
Demand deposits	3,108	3,020	3,308	3,256	3,558	3,893	3,892
Savings and time deposits	1,307	1,234	1,085	1,098	1,068	1,079	1,094
	(Annual percentage change, unless otherwise indicated)						
Reserve money	10.3	-7.1	23.0	10.6	4.0	2.1	1.4
Credit to the private sector	4.1	6.1	0.3	-0.4	0.8	2.0	3.5
Broad money	6.8	-3.1	6.6	1.9	5.3	6.3	1.4
Memorandum items:							
Money multiplier (level)	1.7	1.8	1.5	1.4	1.4	1.5	1.5
Loan-to-deposit ratio (in percent)	67.9	75.5	66.5	59.8	59.4	59.3	60.3
Interest rates (percent per annum)							
Deposit rate 3/	0.3	0.4	0.5	0.5	…	…	…
Lending rate 3/	10.5	10.4	10.7	10.1	…	…	…
NCG of financial corporations	-1,097	-951	-782	-291	102	618	627
91-day treasury bill rate	0.0	0.0	0.5	0.5	…	…	…

Sources: Data provided by the Central Bank of Solomon Islands; and IMF staff estimates and projections.

1/ Based on actual and projected exchange rates.

2/ Includes claims of the CBSI on other (nonbank) financial corporations.

3/ Weighted average of different maturities, period average.

Table 5. Solomon Islands: Core Financial Soundness Indicators, 2016–2022

	2016	2017	2018	2019	2020	2021	2022
	(In percent, unless otherwise indicated)						
Capital Adequacy							
Regulatory Capital to Risk-Weighted Assets	32.5	35.0	31.1	31.3	33.7	32.6	32.9
Non-performing Loans Net of Provisions to Capital	6.6	12.2	11.8	18.0	16.6	13.9	11.6
Asset Quality							
Non-performing Loans to Total Gross Loans	3.8	6.4	7.1	10.4	10.6	10.4	9.4
Specific Loan Loss Provision to NPLs	31.2	18.7	30.9	29.4	29.9	36.4	39.8
Earnings and Profitability							
Return on Assets	3.5	3.9	3.5	3.1	2.1	2.3	3.0
Return on Equity	22.7	23.1	20.4	18.3	11.8	12.5	16.1
Interest Margin to Gross Income	56.3	55.0	54.6	53.6	59.1	57.9	54.1
Non-interest Income to Gross Income	43.7	45.0	45.4	46.4	40.9	42.1	45.9
Liquidity							
Liquid Assets to Total Assets (Liquid Asset Ratio)	38.1	38.4	40.4	37.4	45.4	46.4	47.6
Liquid Assets to Short Term Liabilities	46.9	50.3	59.0	53.5	65.1	66.1	69.2
Net open position in foreign exchange to capital	3.6	3.8	4.1	2.1	2.4	2.9	2.8

Source: Central Bank of Solomon Islands.

Table 6. Solomon Islands: Indicators of Capacity to Repay the Fund, 2023–33

	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
						Proj.					
Fund obligations based on existing credit (in SDR millions)											
Principal	3.6	7.1	4.2	1.4	1.4	1.4	1.4	0.7	0.0	0.0	0.0
Charges and interest	0.7	0.7	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Fund obligations based on prospective credit (in SDR millions) 1/											
Principal	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fund obligations based on existing and prospective credit (in SDR millions)											
Principal	3.6	7.1	4.2	1.4	1.4	1.4	1.4	0.7	0.0	0.0	0.0
Charges and interest	0.7	0.7	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Total obligations based on existing and prospective credit											
In millions of SDRs	4.3	7.7	4.6	1.8	1.7	1.7	1.7	1.0	0.3	0.3	0.3
In millions of US$	5.7	10.3	6.2	2.4	2.3	2.3	2.3	1.4	0.4	0.4	0.4
In percent of gross international reserves	1.0	1.9	1.2	0.5	0.5	0.6	0.6	0.4	0.2	0.3	0.6
In percent of government revenue	1.2	2.1	1.2	0.4	0.4	0.4	0.4	0.2	0.1	0.1	0.1
In percent of exports of goods and services	1.2	2.1	1.3	0.5	0.4	0.4	0.4	0.2	0.1	0.1	0.1
In percent of debt service 1/	80.2	118.0	51.8	19.6	17.9	17.3	12.5	7.2	2.2	2.1	2.1
In percent of GDP	1.2	2.1	1.3	0.5	0.4	0.4	0.4	0.2	0.1	0.1	0.1
In percent of quota	20.7	37.2	22.3	8.4	8.3	8.3	8.3	4.9	1.6	1.6	1.6
Outstanding Fund credit 1/											
In millions of SDRs	17.6	10.5	6.3	4.9	3.5	2.1	0.7	0.0	0.0	0.0	0.0
In millions of US$	23.4	14.0	8.4	6.5	4.7	2.8	0.9	0.0	0.0	0.0	0.0
In percent of gross international reserves	4.2	2.6	1.7	1.4	1.1	0.7	0.3	0.0	0.0	0.0	0.0
In percent of government revenue	5.1	2.8	1.6	1.2	0.8	0.5	0.1	0.0	0.0	0.0	0.0
In percent of exports of goods and services	4.7	2.8	1.7	1.3	0.9	0.5	0.2	0.0	0.0	0.0	0.0
In percent of debt service 1/	326.6	160.1	70.2	54.4	36.1	20.9	5.0	0.0	0.0	0.0	0.0
In percent of GDP	4.7	2.8	1.7	1.3	0.9	0.5	0.2	0.0	0.0	0.0	0.0
In percent of quota	20.7	37.2	22.3	8.4	8.3	8.3	8.3	4.9	1.6	1.6	1.6
Net use of Fund credit (in SDR millions)											
Disbursements	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments and repurchases	-3.6	-7.0	-4.2	-1.4	-1.4	-1.4	-1.4	-0.7	0.0	0.0	0.0
Memorandum items:											
Nominal GDP (in US$ millions)	1,700.7	1,801.4	1,918.7	2,039.1	2,168.6	2,306.4	2,455.5	2,621.1	2,798.7	2,988.6	3,192.1
Exports of goods and services (in US$ millions)	499.2	492.4	495.6	508.9	532.4	550.5	558.7	573.3	588.1	598.2	614.1
Gross international reserves (in US$ millions)	560.7	541.7	498.9	480.5	443.8	410.3	364.0	319.7	250.2	166.1	70.7
Government revenue (in US$ millions)	461.1	493.1	529.0	557.3	590.3	624.7	662.3	702.5	745.6	791.7	840.2
Debt service (in US$ millions) 1/	7.2	8.7	12.0	12.0	13.0	13.5	18.6	19.1	20.5	21.3	21.1
SI/U.S. dollars (period average)	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2
U.S. dollars/SDR (period average)	1.3	1.3	1.3	1.3	1.3	1.4	1.4	1.4	1.4	1.4	1.4
Quota (in SDR millions)	20.8	20.8	20.8	20.8	20.8	20.8	20.8	20.8	20.8	20.8	20.8

Source: IMF staff estimates and projections.

1/ Total public debt service, including IMF repayments.

Annex I. Risk Assessment Matrix[1]

Likelihood	Impact / Time Horizon		Policy Response
Medium	**Medium / ST** **1. Stronger than expected global recovery** A stronger than expected recovery of the global economy, especially China, would improve terms of trade and generate higher demands for exports.	**Upside**	• Take advantage of upside surprises to lock in an improvement in fiscal buffers, as the recovery is firmed up. • Consider ways to use some of the gains to invest in resilient infrastructure and progress towards SDGs.
Medium	**Medium / ST, MT** **2. Accelerated aid inflows** Geopolitical considerations among donors could increase development assistance beyond the economy's absorptive capacity.		
Medium	**High / ST, MT** **1. Local Covid-19 outbreaks** Outbreaks in slow-to-vaccinate countries or emergence of more contagious vaccine-resistant variants force new lockdowns or inhibit commerce. This results in extended supply chain disruptions, slower growth, capital outflows, and debt distress in some EMDEs.	**Downside**	• Raise vaccination coverage through addressing vaccine hesitancy. • Seek additional donor support to save people's lives, contain the outbreak, and support economic activity. • Explore options to maintain economic activity to the extent possible while containing the pandemic.
High	**High / ST** **2. Commodity price shocks** A combination of continuing supply disruptions (e.g., due to conflicts and export restrictions) and negative demand shocks causes recurrent commodity price volatility and social and economic instability.		• Reprioritize fiscal policy to ramp up targeted support for those vulnerable and slow down the execution of public infrastructure projects. • Efforts to diversify the economy and increase the use of renewable energy should be continued
High	**Medium / ST** **3. Fiscal policy slippages, including towards the 2023 Pacific Games and the general elections in early 2024** Higher fiscal spending and weak PFM toward the events could lead to increases in domestic arrears, non-performing loans in the banking sector, and a higher debt burden.		• Enhance accountability of public expenditures including through auditing of fiscal outcomes. • Improve public investment management. • Make efforts to contain spending on the Constitute Development Funds and improve the accountability.
High	**Medium / ST** **4. Under-execution of the budget** Lower-than-expected support from development partners or unsuccessful bond issuance in the shallow domestic market could hinder the implementation of the budget.		• Accelerate reforms that are a condition for budget support. • Estimate donor support realistically. • Reach out to potential investors in domestic bonds to develop their interests.
High	**High / ST, MT** **5. Systemic social unrest** Rising inflation, declining incomes, and worsening inequality amplify social unrest and political instability, causing capital outflows from EMDEs, slowing economic growth, and giving rise to economically damaging populist policies (e.g., preserving fossil fuel subsidies).		• Enhance public investments in health, education, and social protection in an inclusive and transparent manner to address youth unemployment, poverty, and uneven development. • Address government vulnerabilities, including through strengthening anti-corruption efforts.
High	**High / ST, MT** **6. Deepening geo-economic fragmentation and geopolitical tensions** Broadening of conflicts and reduced international cooperation accelerate deglobalization, resulting in a reconfiguration of trade, supply disruptions, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial system, and lower potential growth.		• Continue efforts to mobilize domestic revenues, improve public financial management, and diversify the economy with a view to enhancing resilience against volatile aid inflows and a slowdown of the global economic growth.
Medium	**High / ST, MT** **7. Natural disasters related to climate change** More frequent natural disasters deal severe damage to infrastructure (especially in smaller vulnerable economies) and amplify supply chain disruptions and inflationary pressures, causing water and food shortages and reducing medium-term growth.		• Invest in resilient infrastructure to strengthen climate change adaptation.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("L" (low) is meant to indicate a probability below 10 percent, "M" (medium) a probability between 10 percent and 30 percent, and "H" (high) a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Annex II. External Sector Assessment[1]

Overall Assessment: *Solomon Islands' external position in 2022 was substantially weaker than the level implied by fundamentals and desirable policy settings, based on the results of the IMF's EBA-lite current account model.[1] The current account (CA) deficit is estimated to have widened driven by higher global commodity and fuel prices, slowing global economic growth, and ongoing infrastructure projects. The real exchange rate is assessed as overvalued. Reserve coverage has remained strong but is expected to decline over time. Although the net international investment position -to-GDP ratio is negative and expected to weaken further in the near and medium term, vulnerabilities are limited by the large share of FDI liabilities and high share of concessional liabilities in public external debt.*

Policy Responses: *Improving competitiveness and promoting diversification of exports through structural reforms remains a priority, while better public investment management would also help moderate the CA gap. Grant financing and highly concessional loans should continue to be explored to reduce the pressure on debt accumulation and limit financing costs and risks. Reviewing the currency basket of the exchange rate regime is an increasingly pressing issue, given the estimated overvaluation of the exchange rate.*

Foreign Assets and Liabilities: Position and Trajectory

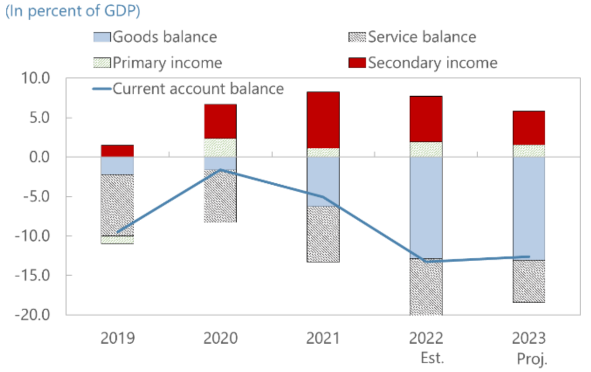
Background. Solomon Islands' net international investment position (NIIP) is estimated to have decreased to -6.1 percent of GDP at end-2022. The change is driven by a drawdown of gross reserves on the assets side and an increase in foreign direct investment (FDI) on the liability side. Reserve assets have remained 76 percent of gross assets. On the liabilities side, FDI represents over 69 percent of gross liabilities, while general government debt accounts for 18 percent.

Assessment. The NIIP-to-GDP ratio is expected to weaken in the near and medium term, as continued CA deficits are projected to lessen gross reserves. The structure of the external balance sheet entails low vulnerabilities, given the large share of FDI liabilities and high concessionality of public external debt.

2022 (% GDP)	NIIP: -6.1	Gross Assets: 51.9	Debt Assets: 6.9	Gross Liabilities: 58.0	Debt Liabilities: 11.3

Current Account

Solomon Islands: Current Account
(In percent of GDP)



Sources: Solomon Islands authorities and IMF staff estimates.

Background. The CA deficit is estimated at 13.3 percent of GDP in 2022, reflecting higher import prices and a drop in log exports. The deficits have been steadily widening in recent years, driven by decreasing log exports and increasing imports for infrastructure projects. The CA deficit is expected to stay high in 2023, as the economic activity is projected to increase towards the 2023 Pacific Games.

Assessment. The revised EBA-lite CA model indicates a negative gap of -5.5 percent of GDP, given an adjusted CA balance of -10.7 percent and an adjusted CA norm of -5.3 percent. The gap incorporates the effects of COVID-19 on tourism (0.9 percent of GDP) and remittances (0.3 percent of GDP) and a temporary increase in imports because of preparations for the 2023 Pacific Games (0.8 percent of GDP). The CA in 2022 is assessed to have been significantly weaker than that consistent with medium-term fundamentals and desirable policy settings.

[1] Prepared by Roman Merga (APD)

Solomon Islands: EBA-lite Model Results, 2022		
	CA model 1/	**REER model** 1/
	(in percent of GDP)	
CA-Actual	-13.3	
Cyclical contributions (from model) (-)	-0.1	
COVID-19 adjustors (-) 2/	-1.2	
Additional temporary/statistical factors (-) 3/	-0.8	
Natural disasters and conflicts (-)	-0.5	
Adjusted CA	-10.7	
CA Norm (from model) 4/	-5.3	
Adjusted CA Norm	-5.3	
CA Gap	-5.5	-2.2
o/w Relative policy gap	1.3	
Elasticity	-0.3	
REER Gap (in percent)	21.4	8.5

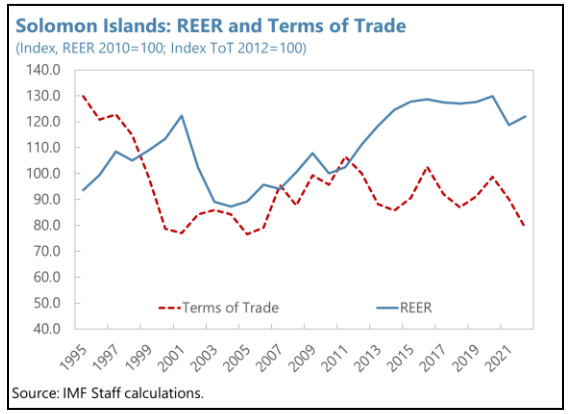
1/ Based on the EBA-lite 3.0 methodology.

2/ Adjustments to account for the temporary impact of the pandemic on tourism (0.9 percent of GDP) and remittances (0.3 percent of GDP).

3/ An additional adjustment to account for the transitory increase in imports driven by the 2023 Pacific Games.

4/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate



Background. The real effective exchange rate is estimated to have appreciated by 9.5 percent in 2022. It is estimated that the terms of trade declined in 2022 by 12 percent, reflecting a decline in log export prices and generally higher import prices.

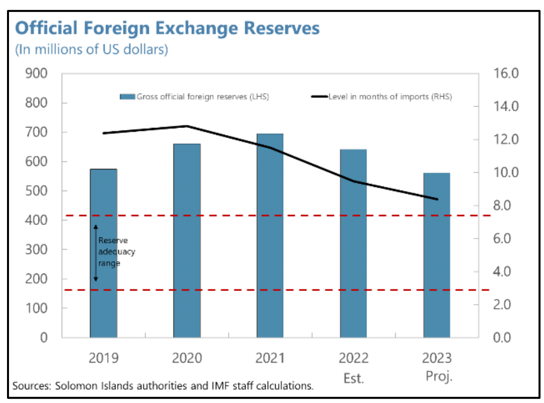
Assessment. The revised EBA-lite methodology using the CA approach suggests the real exchange rate was overvalued by 21.4 percent, while the REER approach suggests that the real exchange rate was overvalued by 8.5 percent compared to the REER norm in 2022. This assessment is consistent with recent developments in the nominal exchange rate and inflation in Solomon Islands and its main trade partners. While this result does not automatically imply a need for nominal exchange rate adjustment, it highlights pressing need to review the weights of the currency basket, the anchor of Solomon Islands' exchange rate regime. Phasing public investment projects in line with the economy's absorptive capacity and enhancing productivity and competitiveness of exports through structural reforms also remain a priority to reduce risks of exchange rate overvaluation.

Capital and Financial Accounts

Background. Solomon Islands' capital and financial account flows are mainly driven by donor project-related capital grants and FDI. The capital balance is estimated to have improved in 2022, reflecting an increase in capital grants from donors related to infrastructure projects. FDI inflows are also estimated to have surged in 2022, reflecting higher reinvested earnings.

Assessment. The capital and financial accounts are expected to remain strong, supported by incremental inflows of capital grants owing to externally financed large infrastructure projects and FDI.

FX Intervention and Reserves Level



Background. Gross official reserves are estimated to have decreased to US$641.0 million (9.5 months of prospective imports) in 2022, from the peak of US$694.5 million in 2021. The decline was driven by the widened current account deficit, partially offset by continuous aid inflows and favorable FDI. The reserve coverage is projected to further decline to 8.4 months of imports in 2023, reflecting the widening CA deficit.

Assessment. A cost-benefit analysis of the level of reserves suggests an optimal level between four and seven months of imports. While the current level of reserves remains well above the adequate range, it is projected to keep declining to 6.3 months of prospective imports by 2027, still within the adequacy range. Fostering sustainability in the forestry sector and export diversification, as well as improving public investment management, help slow down the decline in reserves over the medium term. The weights of the currency basket need to be reviewed to prevent exchange rate misalignments.

[1] The external sector assessment is based on staff's estimates. See The Revised EBA-lite methodology (2019). The revised EBA-lite does not fully capture the characteristics of small states, hence there is significant uncertainty around the estimates used.

Annex III. Country Engagement Strategy[1]

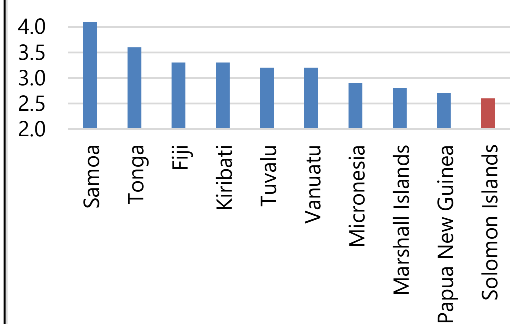
A. Fragility of Solomon Islands and Its Drivers

1. Solomon Islands has made significant strides in rebuilding social and economic stability since the end of the civil unrest[2] in 2003 but economic fragility is still present. The fraction of people living with less than US$1.90 per day has halved from 50.6 percent in 2005 to 25.2 percent in 2022.[3] The IMF supported the post-conflict recovery through a series of IMF-supported programs from 2010 to 2016. But underlying ethnic tensions that triggered the civil unrest persist today, which escalated to a riot that took place in Honiara in November 2021.

2. The country's fragility stems from its geographic nature and historical contexts:

- **Extremely limited connectiveness.** The nearly one thousand islands are separated by vast tracts of ocean, with one of the lowest population densities in the world.
- **Vulnerability to natural disasters and climate change.** The country has a high exposure to cyclones, heavy rainfalls, earthquakes, and tsunamis, accompanied by limited capacity to cope with them.
- **Tenuous national unity.** Pre-colonial traditions based on small clan groups are still in place, fragmenting the society and causing political instability.
- **Weak state institutions.** The quality of public sector management and institutions is assessed to be the lowest in the Pacific.
- **Customary rules.** About 85 percent of the landmass is customary land regulated by unwritten laws and oral tradition, complicating land utilization and fomenting possible corruption.

CPIA: Public Sector Management and Institutions



Source: World Bank, World Development Indicators.

3. Those fragility drivers translate into economic outcomes as follows, constituting additional sources of fragility:

- **Underdeveloped private sector.** The share of the primary sector remains large, including the logging sector where production has been declining because of overexploitation.
- **Insufficient and inequal allocation of physical and human capital.** Limited and inequitable access to infrastructure and public services, especially in rural arears, has driven youth

[1] This Country Engagement Strategy provides an overview of the drivers of fragility, constraints to reform, and reform priorities that inform the strategy for Fund engagement with Solomon Islands. The strategy draws insights from exchanges with the authorities, development partners, and the private sector.

[2] The unrest was driven by tensions between people of Malaita and Guadalcanal, reflecting continuous migration from the former to the latter in search for economic opportunities.

[3] Sustainable Development Report 2022.

unemployment and continuous migration to Guadalcanal, fostering internal tensions.

- **High aid dependency.** Donor grants account for about a quarter of the government's revenue and grants, in addition to significant off-budget capital expenditures funded by donors.
- **Governance and corruption vulnerabilities.** Low governance standards and insufficient accountability for public spending have prevented the efficient use of budget resources and caused depletion of natural resources.

B. Constraints to Reform and Policies to Address the Sources of Fragility

4. Weak state capacity accompanied by political instability and governance vulnerabilities constitutes major constraints to reform in Solomon Islands. They prevent the government from effectively providing public services and making necessary investment to address challenges such as low productivity, inequality, infrastructure gaps, and vulnerability to climate change.

C. Policies to Address the Sources of Fragility

5. The following policies ranging from short-term to medium-term measures could help mitigate the country's fragility:

- **Maintaining macroeconomic stability.** Stable macroeconomic environments underpinned by appropriate support for the vulnerable, a strong fiscal discipline, and robust reserve buffers allow the authorities to undertake necessary investments and reforms.
- **Strengthening fiscal governance and transparency.** Improving public financial management (PFM) such as budget planning, cash management, and transparency of public spending helps enhance the quality and accountability of public expenditure in the medium term.
- **Improving access to public services and infrastructure.** Additional investment to improve access to education, health services, electricity, digital services, and job opportunities in the medium term, especially in rural areas, is critical for developing human capital and promoting national unity.
- **Developing new growth drivers.** Addressing structural bottlenecks such as land registration issues, ineffective dispute resolution mechanisms, and the lack of responsible governance frameworks is needed to promote private sector development.

D. Fund Engagement including Capacity Development Priorities

6. Recent Fund engagement with Solomon Islands has focused on surveillance through Article IV consultations and capacity development (CD). Solomon Islands is the third largest recipient of Fund's CD in the Pacific. The country also received debt service relief through the Catastrophe Containment and Relief Trust and emergency financing under the Rapid Credit Facility and Rapid Financing Instrument.

7. The Fund's CD has been driven by the authorities' demand and well aligned with policy priorities identified through the surveillance process. Recent activities, which include the following, intend to address the sources of fragility, by helping the authorities in maintaining a stable macroeconomic environment and enhancing the quality of public spending:

- **Revenue mobilization:** support the operation of a large taxpayer office, development of a revenue administration reform program, and design of the fiscal regime for mining.
- **PFM:** improve the operations of the PFM Act, budget process, financial reporting, debt management, and monitoring of fiscal risks.
- **Monetary and financial sectors:** support the operations and risk management of the central bank and strengthen banking regulations and the risk-based supervision.
- **Macro statistics:** improve the national accounts, government financial accounts, and BOP.
- **Governance:** strengthen the legal and institutional frameworks for auditing and AML/CFT and protection of correspondent banking relationships.

8. Fund CD has been generally successful, underpinned by the authorities' efforts to internalize the deliverables. The experience offers the following lessons for the Fund's engagement with Solomon Islands:

- Multi-year planning and implementation underpinned by continuous efforts of relationship building with the authorities is warranted.
- In-person technical assistance with hands-on activities and sufficient time has delivered the most tangible benefits. Virtual sessions could be useful, but have occasionally faced challenges.
- Proposed reforms should be carefully sequenced and tailored to the country's circumstances and absorptive capacity.
- Possible turnover of officials should be factored in.

9. The Fund's engagement with Solomon Islands should remain centered around surveillance and CD. The near-term CD priorities should continue to be focused on ramping up the authorities' basic capacity that lays a foundation for implementing sound macroeconomic policies. Imminent CD needs include the reporting and accountability of public spending, public investment management, review of the exchange rate basket, the central bank's internal audit, and macroeconomic statistics. The IMF's CD could support the authorities to develop medium-term frameworks including on fiscal policy, revenue mobilization, and green PFM, but only over the medium term after they build up sufficient capacity. Should the authorities be interested, having an IMF-supported program would help maintain macroeconomic stability, build capacity, and catalyze donor support including for climate mitigation.

10. Close coordination with development partners is critical, especially given the Fund's limited field presence. Conventional donors such as the Asian Development Bank (ADB), World Bank, United Nations agencies, European Union, Australia, New Zealand, Japan, and the US provide development assistance reflecting their respective mandate and expertise. The Fund has maintained close cooperation with those development partners, as well as non-governmental organizations. Roll-sharing and synergies with them could be further explored, such as with the World Bank on PFM, the ADB on tax policy, and the United Nations Development Program on anti-corruption and money laundering.

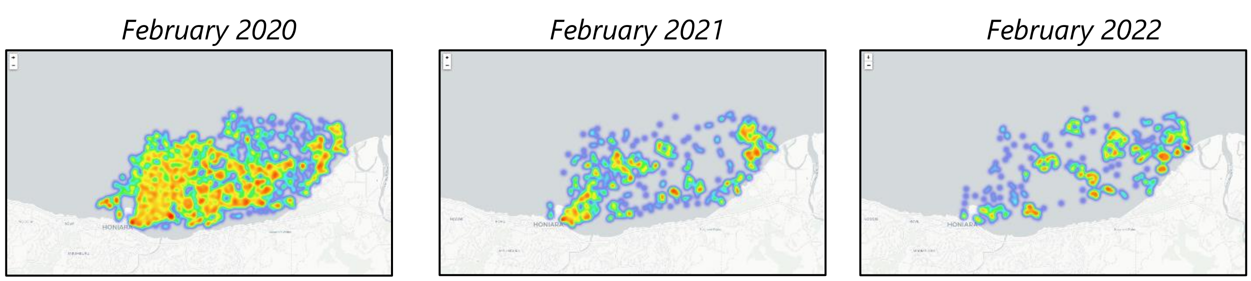
11. The IMF engagement with Solomon Islands involves significant risks. The manifestation of political tensions as seen in the riot in November 2021 could jeopardize Fund engagement. Even if there is no disruption, government reforms could stall before the general elections scheduled for early 2024, as was the case in 2019. A deterioration of external economic conditions, natural disasters, and a rise in geopolitical tensions could undermine macroeconomic stability, given Solomon Island's limited resilience and dependence on commodities and aid inflows. Turnover of officials and weak institutional capacity act as a drag on the pace of economic reforms.

Annex IV. Using Big Data to Fill Data Gaps for Solomon Islands[1]

1. **The COVID-19 pandemic has emphasized the need for timely economic activity indicators during unprecedented events; in turn, the use of unconventional data in surveillance is becoming increasingly common.** However, many of these indicators, such as Google's mobility reports, are not available for Pacific Islands countries (PICs) given their small size and remote location. Official high frequency data is scarce, and oftentimes is available with a lag of two to three months. One data source that can be used to fill in data gaps for PICs is the Automated Identification System (AIS) data, a tracking system for ships that compiles vessel-traffic data. AIS data can be used to estimate port activity and trade flows, allowing for almost immediate indicators (with a lag of just a couple of days) and for tailored granularity, as the user decides on the level of aggregation.

2. **We use the AIS satellite data to proxy economic activity around the ports of Solomon Islands, and we nowcast the volume of monthly trade flows.**[1] The indicators we compute are likely highly correlated with economic activity, as for Solomon Islands good imports represent 30 percent of GDP (2017-2021 average), 80 percent of merchandise imports take place by sea, and annual imports have a correlation coefficient of 0.94 with GDP (measured in US dollars, 1995 to 2021). Additionally, economic activity in PICs has been found to be highly dependent on ports, with up to 45 percent of activity dependent on ports (see Verschuur, Koks, and Hall, 2021).

Figure 1. Solomon Islands: Heat Maps of Port Activity in Honiara During the COVID-19 Pandemic

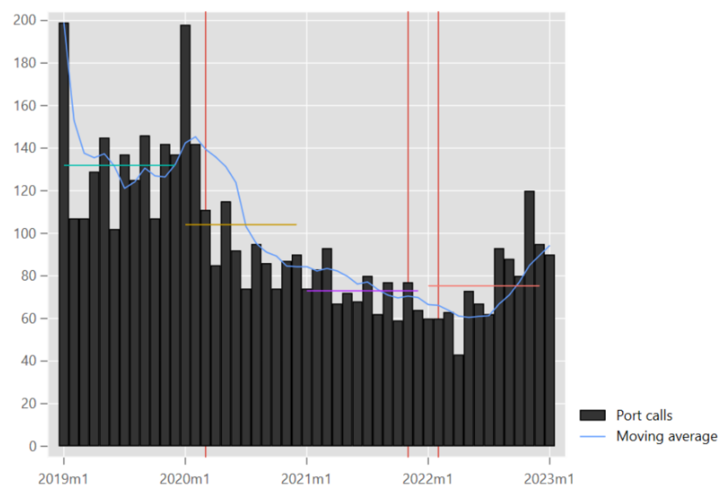


Source: AIS data.
Note: February 2020 shows ships activity in the Honiara port before the start of the COVID-19 pandemic, February 2021 shows port activity when domestic and foreign mobility restrictions were in place but no domestic outbreak, February 2022 shows port activity during the domestic COVID-19 outbreak.

[1] We apply a simplified version of Arslanalp, Koepke and Verschuur (2021) [AKV] to produce our trade nowcasts. The AIS data has been used by IMF staff and official statistics institutes to complement official data and to provide high-frequency indicators where official data is missing, for more details please see the references in AKV. We access the AIS data through the UN's Global Data Platform.

3. Port activity decreased substantially in 2020 and 2021, by 27 percent and 42 percent when compared to the 2019 average, while 2022 activity, although increasing, has remained subdued at the 2021 depressed level. We measure port activity by the number of monthly port calls received in all the Solomon Islands ports. From the raw AIS data, we drop observations that only appear once within the port bounds, as these would not have an "exit" counterpart. Since we are interested in overall activity, we do not apply any other filters at this stage. As proof of concept, Figure 1 heat maps show a clear decline of port activity in the Honiara port during February 2020, 2021, and 2022. The heat maps use all the AIS location data within the Honiara port, the brighter towards red, the more activity took place in that spot. More formally, Figure 2 shows the computed number of port calls implied by the ships' location activity from January 2019 to December 2022, showing the abrupt fall in 2020 and the incipient recovery that started from mid-2022.

Figure 2. Solomon Islands: Port Activity in Solomon Islands



Source: IMF staff estimates based on AIS data.
Note: black bars represent monthly port calls of all types (commercial, tourism, oil tankers, military, etc), the blue line represents the six-month moving average, and horizontal lines are the yearly averages.
Vertical red lines represent: the start of the COVID-19 pandemic (March 2020), the November 2021 Honiara riots, and the domestic outbreak of COVID-19 (February 2022).

4. Our trade flow estimates show a lot of dynamism on the import front, with import volumes responding quickly to external and internal conditions, while on the export front the decrease due to the pandemic has shown little to no recovery since 2021. To estimate trade flows, we further filter port calls to keep only those related to trade. We only include container ships, vehicle carriers and bulk carriers. Given the characteristics of trade flows in Solomon Islands, we exclude all other types of vessels, including fuel tankers and fishing vessels. We also exclude port calls that are too short (less than five hours), as they are unlikely to have enough time to represent meaningful trade activity. We estimate the utilization of ships by combining information on ships characteristics (length, width, cargo capacity) with the change in the AIS record of the vessel's draught as in AKV. Figure 3 shows our volume estimates for imports (Panel A) and exports (Panel B), together with the monthly merchandise imports and exports values in domestic currency provided by CBSI (usually with a lag of two to three months). Differences between the import volume estimates and value indicators point to increases in shipping costs and global supply chain disruptions (second half of 2021) and increases in shipping costs and commodity prices in 2022 due to the war in Ukraine. For exports, we estimate a fall of 64 percent in 2021 and 2022 with respect to 2019. Our export volume estimate features a large boom at the end of 2019 and beginning of 2020 that we need to validate with other data sources and the authorities.

5. Big data can be used to fill data gaps for PICs and the Fund can serve as a capacity-building and innovation hub. Fund staff will further work on validating the estimators computed based on AIS data through discussions with the authorities, as well as providing the indicators for use by the CBSI staff in a broader nowcasting effort under IMF Technical Assistance. The current exercise showcases the potential for surveillance and TA integration in building capacity and filling data gaps.

Figure 3. Solomon Islands: Trade Indicators

Panel A: Import Volume | **Panel B: Export Volume**

Source: IMF staff estimates based on AIS data.
Note: the imports volume estimate considers only activity from the Honiara port, which is the main port for merchandise imports in Solomon Islands. The exports volume estimate considers activity from all ports, since exporting activity takes place in ports other than Honiara given the type of commodity exported.

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Arslanalp, S., R. Koepke and J. Verschuur, 2021, "Tracking Trade from Space", IMF Working Paper 21/225.

Verschuur J., E. E. Koks, J. W. Hall, 2021, "Ports' Criticality in International Trade and Global Supply-Chains" mimeo.

UN Committee of Experts on Big Data and Data Science for Official Statistics - The AIS Task Team, United Nations Global Data Platform. https://unstats.un.org/bigdata/task-teams/ais/index.cshtml

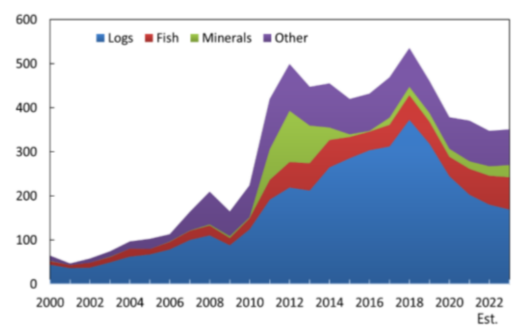
Annex V. Diversifying Solomon Islands' Exports amid China's Slowing Potential Growth: Key Issues and Lessons Learned from Historical Experience[1]

Solomon Islands' exports lack diversity both in terms of products and destinations: before the pandemic, around 65 percent of the country's exports were woods products to China. Diversifying exports is a pressing priority for the country in light of the declining logging activity and slowing growth of Chinese market. It is estimated that Solomon Islands' exports could be reduced by 15 percent owing to the recent downward revision of China's potential output growth by the IMF. Staff analysis suggests that Solomon Islands' export potential lies on improving the performance of products that have newly entered to the export markets, so that they can stay longer in foreign markets and increase their export volume. Supporting investment by exporters to enhance the quantity and quality of their export products and targeted export promotion would help export growth. The currency basket of the exchange rate regime should be reviewed to ensure the competitiveness of the export sector.

1. Solomon Islands' exports drove post-conflict recovery from early 2000s to late 2010s. Exports significantly increased from US$47 million (6.5 percent of GDP) in 2001 to US$536 million in 2018 (33 percent of GDP), achieving an average 15 percent growth per year (Figure 1). This rapid and sustained export growth contributed to GDP growth and the accumulation of foreign reserves. The main driver was log exports, which increased tenfold during the period. Timber products accounted for 70 percent of total exports in 2018. Other exports included fish, cash crops (e.g., palm oil and copra), and minerals (e.g., gold and silver), although the contribution to total exports remained limited.

Figure 1. Solomon Islands: Exports Evolution

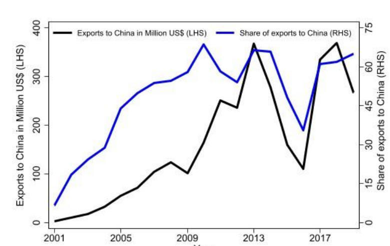
(Nominal Exports in Millions US$)



Sources: Solomon Islands authorities and IMF staff estimates.

2. Sales to China accounted for most of the export growth. Exports to China grew rapidly from US$2.4 million in 2001 to US$336 million in 2018, increasing the share of total exports from less than 15 percent to 62 percent (Figure 2). 98 percent of exports to China during the period were wood products (Figure 3). Exports to Italy and India also rose during this period, driven by exports of fish products and palm oil. Export concentration elevated as a result: the share of exports to top five destinations increased from 84 percent in 2001 to 90 percent in 2018.

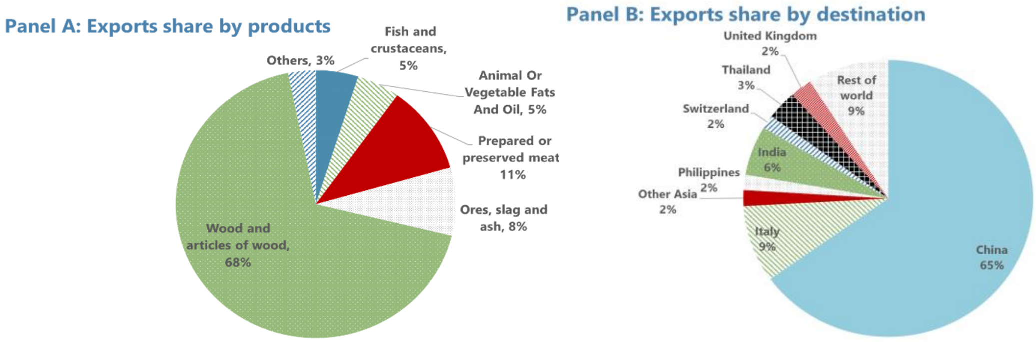
Figure 2. Solomon Islands: Exports to China



Source: IMF staff estimates based on CEPPI data.

[1] Prepared by Roman Merga (APD).

Figure 3. Solomon Islands: Exports Basket

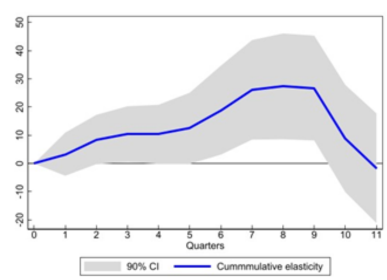


Source: IMF staff estimates based on CEPPI data.
Note: The baskets are calculated for the year 2019.

3. Exports have been on a downward trend since 2019 that is expected to continue. Export earnings of goods are estimated to have decreased to US$348 million in 2022, compared to US$536 million in 2018, dragging down GDP growth and lessening reserve coverage. The stagnant exports stem from two factors, both of which are expected to continuously weigh on exports over the medium term. The first is a decline in the logging sector, caused by overexploitation of forest resources over the years. The Logging Sustainability Policy adopted in 2018 implies that logging activity will halve in 2023, if implemented effectively. The second is slowing China's demand for logs, driven by the recent turmoil in the real estate market. As a result, the price of round logs in the global market dropped to US$209 per cubic meter in November 2022, a 23 percent reduction compared to the 2018 price of US$270.

4. China's slowdown could have a significant and lasting impact on Solomon Islands' exports. It is estimated that the recent -0.6 percentage point revision of China's potential output growth, estimated by the IMF, could reduce Solomon Islands' exports by 6 percent after four quarter and around 15 percent after two years (Figure 4). But the estimate needs to be treated with caution as it has a wide confidence interval, and the impact could be potentially overestimated owing to common factors that in the past affected both China and Solomon exports together, and the decline in logs exports with primarily destination to China in the past.

Figure 4. Solomon Islands: Effect of Chinse Growth in Exports

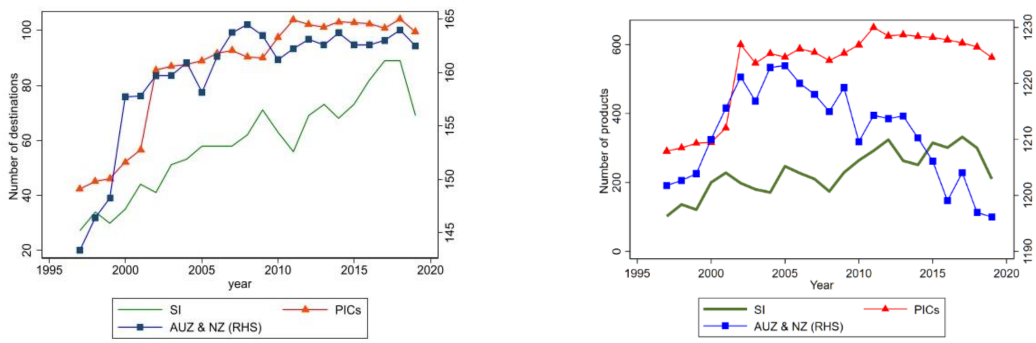


Source: IMF staff estimates based on CEPPI data.
Note: The result shows the cumulative export change to a 1% change in Chinese long-term growth. Estimation using Jorda (2005) local projection methods.

5. Finding alternative drivers of exports is a pressing priority for Solomon Islands. Minerals are expected to partially offset the declining log exports over the medium term, supported by the country's rich mineral resources of gold, nickel, and bauxite with the recent re-starting of gold exports. That said, it should be noted that the mining sector is associated with the same vulnerabilities and risks as log exports: it could be affected by an economic slowdown in China and entails the risk of damaging the environment if there are no effective governance standards and regulations. Therefore, diversifying exports both in terms of products and destinations is needed to reduce vulnerability of the economy and enhance growth prospects.

Figure 5. Solomon Islands: Total Exports Destination and Products Evolution

Panel A: Total Number of Destinations **Panel B: Total Number of Products**



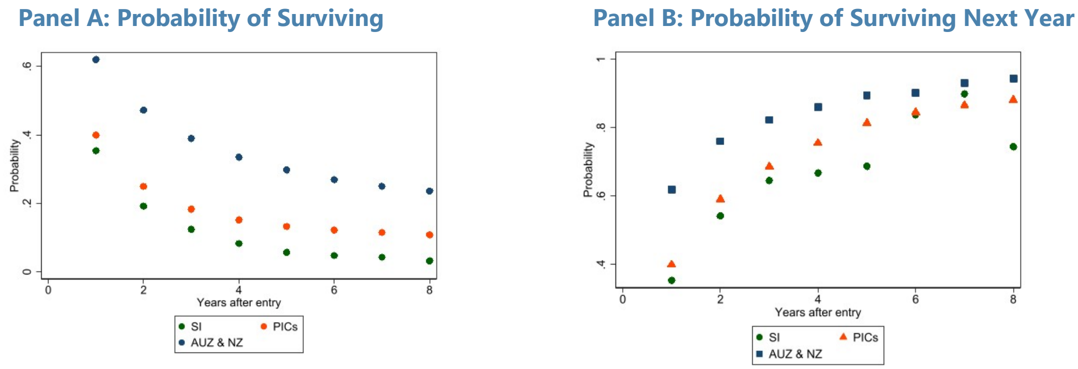
Source: IMF staff estimates based on CEPPI data.

Note: Panel A shows the total number of destinations. Panel B shows the total number of products at four-digit level.

6. Solomon Islands expanded its destinations and export items historically, although it is lagging other Pacific Island Countries (PICs), especially in terms of the number of export items. Solomon Islands significantly increased the number of its export destinations from 44 in 2001 to 69 in 2019 (Figure 5, Panel A). The number of Solomon Islands' export products kept increasing until 2018, illustrating that the economy has the potential of introducing new export products to the global markets, although the number of export products has dropped since then (Figure 5, Panel B). Compared to other PICs, Solomon Islands has lagged behind especially in terms of the number of export products, while its number of export destinations has been gradually catching up. Therefore, the rest of the analysis is focused on the aspect of export products.

7. Low survival probabilities of Solomon Islands' export products explain its low export diversification (Figure 6). More than 90 percent of Solomon Islands' export products exit from their export markets within 5 years after entry, while above 15 percent of PIC's products are estimated to stay in their markets for the same duration. There is a 67 percent chance that a Solomon Islands' product that has stayed in the export market for 5 years will stay in the market for another one year, compared to almost 80 percent for PICs.

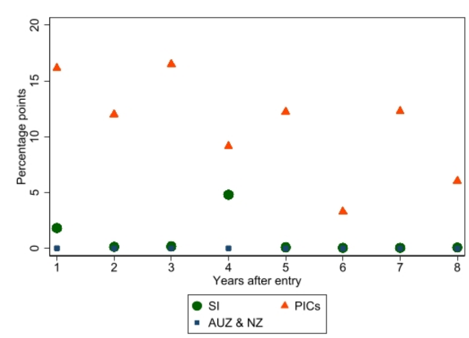
Figure 6. Solomon Islands: New Products Survival Probability by Age



Source: IMF staff estimates based on CEPPI data.
Note: Panel A shows the probability of surviving of a new product up to the given age. Panel B shows the probability of surviving next year conditional on the age of the product.

8. Solomon Islands' export products do not grow much after their entry to the export markets. Along with the low survival probabilities, the contribution of relatively new export products to the total export growth is quite limited for Solomon Islands. Export products that survive between 5 to 8 years after entry markets account for only 1.7 percent on average of total export growth for Solomon Islands, compared to 11.5 percent for PICs (Figure 7). These findings highlight the necessity of enhancing the competitiveness of existing export products, so that they can stay longer in foreign markets. Recent new export products that have managed to remain in the markets for several years include wool, raw hides and skins, and carpets.

Figure 7. Solomon Islands: New Products Contribution to Export Growth



Source: IMF staff estimates based on CEPPI data.
Note: Share of total contribution to export growth of survived products by age.

9. Targeted policy support for exporters to enhance both quantity and quality of their products would help export growth. Staff analysis suggests that compared to other Pacific Island countries, Solomon Islands has more potential in improving the performance products that have newly entered to the export markets, so that they can stay longer in their markets and increase their export volume. To this end, it would be critical to create an economic environment conducive to private sector development, including greater participation of foreign companies. Key steps would include (i) improving access to short and long-term credit (Kohn et al 2016, Manova 2013), (ii) facilitating foreign direct investment (Harding et al 2012), (iii) reducing the costs of border compliance and port handling (Djankov et al 2010), and (iv) improving contract enforceability

(Levchenko 2007).[2] Planning export promotion campaigns to targeted markets in the ASEAN region and Europe could help develop new markets and improve the survivability of export products in these markets. Re-evaluating the exchange rate basket is a priority, to ensure the competitiveness of the export sector over the medium term.

[2] Specific policies could include promoting the use of a greater variety of properties as collateral; codifying a general law of contract based on the existing rules; reducing the port handling costs; and allowing electronic submission of information required by customs.

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Annex VI. Priorities for FY23

Topic	Sub-Topic	TA Description	Comments
Public Financial Management	Budget planning and reporting	Improved budget planning and quality of fiscal reporting	The budget process needs to be improved to be better integrated with donor support. Fiscal reporting should be based on consistent classification of spending.
	Public financial management laws and institutions	Stronger PFM laws and institutions	Regulations under the PFM Act need to be reviewed and finalized.
	Cash flow forecasts	Better cash flow forecasts	The authorities' capacity for cash flow forecasting needs to be improved to prevent payment arrears.
Revenue Administration	Revenue Administration and Governance	Strengthened revenue administration, management, and governance arrangements	Support the implementation of the Tax Administration Act including through organizational reforms.
Revenue Policy	Tax and non-tax revenue policy	Improved tax and non-tax revenue policy	TA will assist the designing of mineral royalties.
Banking Supervision and Regulation	Regulatory & Prudential Framework	Formulate and implement a framework for stress testing of financial institutions	TA will assist formulating a framework for stress testing of financial institutions and risk-based supervision and its implementation.
Central Bank Operations	Internal Audit	Strengthened internal audit function	TA will support developing a multi-year capacity building plan for the internal audit function.
Foreign Exchange Rate Policy	Operation of the exchange rate regime	Foreign exchange rate better aligned to the fundamentals	TA will support reviewing the weights of the currency basket of the exchange rate regime.
Macroeconomic Statistics	Statistics on the Real Sector and Government Finance	Strengthen compilation and dissemination of real sector statistics and Government Finance Statistics	TA will continue in the compilation of the national accounts, debt statistics, and GFS.
Economic Analysis and Modelling, Monetary Policy Framework and Communications (FPAS)	Monetary Policy, General Macroeconomic Analysis	Develop tools to improve economic analysis and forecasting capabilities, streamline the decision-making process, and strengthen the monetary policy communication strategy at the Central Bank	Support the central bank to develop analytical and forecasting capacity to improve economic analysis and forecasting capacities, modernize their monetary policy framework, and strengthen the communications.
Governance and Anti-Corruption	AML/CFT	Formulate a legal framework for AML/CFT	TA will continue to help formulate a legal framework meeting the FATF standards and develop risk-based AML/CFT supervisory tools.
	Audit of public spending	Better audit of public spending	TA will continue enhance capacity of the Auditor General's office.

Annex VII. Authorities' Response to Fund Policy Advice

Fund Recommendation	Policy Actions
Fiscal Policy	
Rebuild fiscal buffers as the recovery is secured and prioritize spending needs towards SDGs.	The authorities acknowledged their commitments to making progress towards SDGs in line with their National Development Strategy, while maintaining fiscal sustainability.
Promote transparency and accountability of public expenditure, including on the CDFs.	The Ministry of Finance and Treasury started to publish budget documents including fiscal outcomes after 2020. More resources need to be allocated to the Auditor General's office to ensure appropriate and timely audit of public expenditures.
Promote domestic revenue mobilization including through more efficient tax administration.	Tax reforms are progressing. Tax Administration Act was adopted, and authorities are working on implementing the Act. The value-added tax (VAT) policy is expected to be tabled in parliament in 2023.
Strengthen public financial management.	The authorities improved financial accounting and reporting with technical assistance from PFTAC. Further efforts are needed to enhance Solomon Islands' public financial management.
Monetary and Financial Sector Policy	
Strengthen supervisory and regulatory framework for the financial system.	The authorities have strengthened their capacity for regulating and supervising the financial sector including with capacity development support from the IMF.
Strengthening the AML/CFT framework.	The Authorities have introduced a National Strategic Plan in 2021 and are working to update its legal framework to comply with the FATF standards.
Improve analytical and forecasting capacity of the central bank.	The central bank has improved its analytical and forecasting capacity through utilizing high frequency indicators and establishing forecasting models supported by the IMF.
Exchange Rate Policy	
Maintain the exchange rate basket peg but improve exchange rate management by reviewing the currency basket's composition on a regular basis.	The currency basket of the exchange rate regime continues to move in a tight band against the U.S. dollar. The weights in the basket have not been reviewed. The central bank requested TA by the IMF to review the currency basket.
Structural Reforms	
Manage the transition from logging to new growth areas. A better business environment would help diversify activity and sustained growth. Strengthening the anti-corruption framework.	The authorities expect to finish the Enhance Integrated Framework (EIF) in 2023, supported by the World Trade Organization, to reinforce agriculture and help farmers increase their productivity and export capacity. Gold Ridge reopened and restarted gold exports in 2022, but a new mining legislation is yet to be submitted to the Parliament.

INTERNATIONAL MONETARY FUND

SOLOMON ISLANDS

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

April 7, 2023

Prepared By	Asia and Pacific Department (in consultation with other departments)

CONTENTS

FUND RELATIONS

(As of February 28, 2023)

Membership Status: Joined September 22, 1978; Article VIII

General Resources Account:

	SDR Million	Percent of Quota
Quota	20.80	100.00
Fund holdings of currency	31.52	151.55
Reserve position in the Fund	3.15	15.14

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	29.84	100.00
Holdings	20.10	67.35

Outstanding Purchases and Loans:

	SDR Million	Percent of Quota
Emergency Assistance[1/]	13.87	66.68
RCF Loans	6.93	33.32
ECF Arrangements	0.37	1.79

[1/] Emergency assistance may include ENDA, EPCA, and RFI.

Latest Financial Commitments:

Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF	12/7/2012	3/31/2016	1.04	1.04
SCF	12/6/2011	12/5/2012	5.20	0.00
SCF	6/2/2010	12/1/2011	12.48	12.48

Outright Loans:

Type	Date of Commitment	Date Drawn	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
RCF	6/1/2020	6/3/2020	6.93	6.93
RFI	6/1/2020	6/3/2020	13.87	13.87

[1/] Undrawn outright disbursements (RFI and RCF) expire automatically 60 days following the date of commitment, i.e., Board approval date.

Projected Payments to Fund:[1/]

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2023	2024	2025	2026	2027
Principal	3.62	7.05	4.23	1.42	1.39
Charges/Interest	0.70	0.71	0.41	0.34	0.34
Total	4.31	7.76	4.65	1.75	1.72

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Implementation of HIPC Initiative: Not applicable.

Implementation of MDRI Assistance: Not applicable.

Implementation of CCR:

Date of Catastrophe	Board Decision Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
N/A	4/13/2020	0.06	0.06
N/A	10/2/2020	0.07	0.07
N/A	4/1/2021	0.10	0.10
N/A	10/6/2021	0.06	0.06
N/A	12/15/2021	0.04	0.04

As of February 4, 2015, the Post-Catastrophe Debt Relief Trust has been transformed to the Catastrophe Containment and Relief (CCR) Trust.

Exchange Rate Arrangement:

The de jure exchange rate arrangement is a conventional peg arrangement. The Solomon Islands dollar (SBD) is pegged to an invoice-based weighted basket of currencies consisting of the US dollar (USD) (with the weight of 58 percent), the Australian dollar (AUD) (32 percent), the New Zealand dollar (5 percent), the Japanese yen (3 percent), and the British pound (2 percent). The basket weight index is allowed to move and fluctuate along the market movement with no fixed band imposed on the basket movement. The exchange rate is allowed to move along the exchange rate basket and market fundamentals. The Central Bank of Solomon Islands (CBSI) sets the exchange rate vis-à-vis the US dollar in such a way as to maintain the value of the basket constant in SBDs given the movements of currencies in the basket relative to each other. Commercial banks may affect payments without CBSI approval up to specified limits for personal and travel remittances and for trade and services payments. Payments for current transactions above specified limits require CBSI approval. All capital and financial repayments require CBSI assessment and approval. Commercial banks can exchange SBD against other currencies and are free to set the bid-ask spread for all currencies, except USD and AUD on which there is a spread limit of ±20 and ±25 basis points (bps), respectively. In addition, CBSI maintains a standing facility through which it will buy and sell foreign exchange with commercial banks and the government at spot offer and sell rates. Since March 2022, the exchange rate increased its flexibility while still being managed. Accordingly, the *de facto* exchange rate arrangement was reclassified to "other managed" from "crawl-like", effective March 22, 2022. Solomon Islands has accepted the obligations of Article VIII and maintains an exchange system that is free of restrictions on making of payments and transfers for current international transactions and multiple currency practices.

Last Article IV Consultation:

The 2021 Article IV Consultation discussions were held remotely during October 18-November 5, 2021. The staff report (IMF Country Report No. 22/14) was considered by the Executive Board and the consultation concluded on January 7, 2022.

Technical Assistance:

Experts from PFTAC and HQ provided support for capacity development in areas of revenue administration, minerals pricing and associated revenue risks, public financial management, macroeconomic frameworks, banking regulation and supervision, AML/CFT, and statistics (national accounts, government financial accounts, and financial soundness indicators).

Resident Representative:

The resident representative office in the Pacific Islands was opened in September 2010 in Suva, Fiji. Mr. Neil Saker is the current Resident Representative.

RELATIONS WITH OTHER IFIS

- World Bank Group:

  http://projects.worldbank.org/search?lang=en&searchTerm=&countrycode_exact=SB

- Asian Development Bank:

  https://www.adb.org/countries/solomon-islands/main

- Pacific Financial Technical Assistance Center:

  https://www.imf.org/en/Countries/SLB

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings but is broadly adequate for surveillance.
National Accounts: Solomon Islands National Statistics Office published GDP estimates up to 2020 in April 2022 using 2012 as the base year. Pacific Financial Technical Assistance Center (PFTAC) has provided technical assistance to compile the national accounts.
Price statistics: A monthly consumer price index (CPI) covering the provincial urban centers of Honiara, Auki, Noro, and Gizo is released within two months of the reference period. The weights are based on the 2012/13 Household Income and Expenditure Survey (HIES) and to be updated with the results of the new HIES that is expected to be finished in 2024.
Government finance statistics: The Ministry of Finance and Treasury (MoFT) commissioned a new financial management information system (FMIS)—Microsoft Dynamics 365 (D365) in October 2021. The new FMIS included the configuration and implementation of a new chart of accounts (CoA). The new CoA was not designed to bridge the data to the Government Finance Statistics Manual 2014 (GFSM 2014), and as a result has impacted the compilation of granular annual fiscal statistics aligned to the GFSM 2014. There is also no continuation of the publication of monthly fiscal data for the budgetary central government on the MoFT website. The authorities collect disbursement information on donors' grants, including those unappropriated in the budget, however data collected by the CBSI's BOP unit and that of the Ministry of National Planning and Development Coordination (MNPDC) do not reconcile. The donor data collected by the MNPDC are used by the CBSI in the compilation of fiscal statistics as they are regarded as the most reliable source of information. Monthly public sector debt statistics (PSDS) are published, and the quality of debt data has improved through better coordination between the MoFT and the CBSI. PSDS for the central government are submitted to the World Bank debt database, quarterly and annually. PFTAC will continue to work with the authorities to improve the quality of GFS and PSDS, including finding solutions to bridge the new CoA to the GFSM 2014 and expanding institutional coverage.
Monetary and financial statistics: The CBSI publishes monthly monetary and financial statistics (MFS) in summary form and reports data for the central bank, other depository corporations, and other financial corporations to the IMF's Statistics Department using the standardized report forms (SRFs). An integrated monetary database meeting the monetary data needs of the CBSI, APD and STA is in operation. The CBSI reports data on several series indicators of the Financial Access Survey (FAS) including mobile and internet banking, mobile money, gender-disaggregated data, and the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs). **Financial Soundness Indicators:** Financial soundness indicators (FSI) are reported quarterly to STA. Currently the CBSI reports 14 core and 7 additional FSI for deposit takers (DTs) and one additional FSI for real estate markets to the IMF. FSIs for other financial corporations (OFCs) and non-financial corporations (NFCs) are not reported yet. FSIs are in line with the IMF's 2019 FSIs Compilation Guide.
External Sector Statistics: The CBSI publishes monthly a subset of external sector statistics including total exports, imports, trade balance, exchange rates, and gross foreign reserves. The CBSI has been compiling quarterly balance of payment and international investment position (IIP) statistics by using data sources such as the Foreign Exchange Transaction System (FET) and different surveys. Coordinated Direct Investment Data (CDIS) have been compiled since 2014 and reported to IMF Statistics Department for publication. Data on quarterly gross external debt positions including public sector debt, publicly guaranteed private sector debt, and private sector debt not publicly guaranteed, are compiled and disseminated through the World Bank Quarterly External Debt Statistics database. Solomon Islands has been one of the beneficiaries of Japan Administered Account Project on the improvement of external sector statistics. Several technical assistance (TA) missions have been conducted under this project. CBSI staff have also attended several external sector statistics training sessions. External sector statistics are in line with the latest methodology (*BPM6)* with further progress needed in the scope and classifications of some statistics.

II. Data Standards and Quality	
Solomon Islands is a participant of the Enhanced General Data Dissemination System (e-GDDS) since June 2011 but has no National Summary Data Page.	No data ROSC is available.

Solomon Islands: Table of Common Indicators Required for Surveillance

(As of March 2023)

	Date of latest observation	Date received	Frequency of Data 7/	Frequency of Reporting 7/	Frequency ofPublication 7/
Exchange Rates	Jan-23	Feb-23	D	W	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities 1/	Jan-23	Feb-23	M	M	M
Reserve/Base Money	Jan-23	Feb-23	Q	Q	Q
Broad Money	Jan-23	Feb-23	M	M	M
Central Bank Balance Sheet	Jan-23	Mar-23	M	M	M
Consolidated Balance Sheet of the Banking System	Dec-22	Feb-23	M	M	M
Interest Rates 2/	Jan-23	Feb-23	M	M	M
Consumer Price Index	Dec-22	Feb-23	M	M	M
Revenue, Expenditure, Balance and Composition of Financing 3/ – GeneralGovernment 4/	NA	NA	NA	NA	NA
Revenue, Expenditure, Balance and Composition of Financing 3/– CentralGovernment	Sep-22	Nov-22	Q	Q	Q
Stocks of Central Government and CentralGovernment-Guaranteed Debt 5/	Sep-22	Oct-22	M	M	M
External Current Account Balance	Sep-22	Nov -22	Q	Q	Q
Exports and Imports of Goods and Services	Sep-22	Nov -22	Q	Q	Q
GDP/GNP	2020	Apr-22	A	A	A
Gross External Debt	Sep-22	Nov -22	Q	Q	Q
International Investment Position 6/	Sep-22	Nov -22	Q	Q	Q

1/ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

2/ Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes andbonds.

3/ Foreign, domestic bank, and domestic nonbank financing.

4/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social securityfunds) and state and local governments.

5/ Including currency and maturity composition.

6/ Includes external gross financial assets and liability positions vis-à-vis nonresidents.

7/ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); and not available NA).

INTERNATIONAL MONETARY FUND

SOLOMON ISLANDS

April 7, 2023

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

Approved By
Thomas Helbling (IMF)
Manuela Francisco and Hassan Zaman (IDA)

Prepared by the staff of the International Monetary Fund (IMF) and the International Development Association (IDA)

Risk of external debt distress:	Moderate
Overall risk of debt distress:	Moderate
Granularity in the risk rating:	Substantial space to absorb shocks
Application of judgement:	No

The 2023 Debt Sustainability Analysis (DSA) indicates that the risk of debt distress in Solomon Islands remains moderate with substantive space to absorb shocks; the rating is unchanged from the 2021 DSA[1]. Debt coverage has remained unchanged compared to the 2021 DSA (IMF Country Report No. 21/211). All external debt indicators remain below the relevant indicative thresholds under the baseline scenario but breach the threshold of the PV of external debt-to-exports ratio under an export shock scenario. The PV of public debt-to-GDP ratio remains below the indicative threshold under the baseline scenario but breaches the threshold under various alternative scenarios including a commodity price shock. A tailored natural disaster shock of similar scale to the largest historical shock would also cause a significant deterioration in the debt trajectory. While the DSA suggests that there is substantial space to absorb shocks, Solomon Islands faces significant fiscal liquidity challenges stemming from the current low level of the government cash balance and rising fiscal risks including from mismanagement of infrastructure projects. Those projects include large-scale investments to host the 2023 Pacific Games as well as a cell phone tower expansion project. A sizable shift to domestic financing projected in the medium term could bring about serious risks in debt management. With pronounced uncertainty around the economic outlook, debt sustainability needs to be anchored by a prudent fiscal policy to rebuild fiscal buffers, while creating fiscal space for meeting development spending needs through stronger revenue mobilization measures and expenditure rationalization.

[1] Solomon Islands Composite Index (CI) is estimated at 2.59 based on the October 2022 World Economic Outlook and the 2021 Country Policy and Institutional Assessment (CPIA), indicating that the debt-carrying capacity remains weak, as in the 2021 DSA.

PUBLIC DEBT COVERAGE

1. **The coverage of public sector debt used in this report is central government debt, central government guaranteed debt, and central bank debt borrowed on behalf of the government**. Debt coverage has remained unchanged since the 2021 DSA. Because of data limitations, other elements in the general government, non-guaranteed state-owned enterprise (SOE) debt, and private external debt are not included in the analysis. The authorities are continuing their efforts to improve data coverage, in particular that of the general government, with support from the IMF. The DSA uses a residency-based definition of external debt. The central government's domestic arrears, where relevant, are included into debt coverage.

Text Table 1. Coverage of Public Sector Debt

	Subsectors of the public sector	Check box
1	Central government	X
2	State and local government	
3	Other elements in the general government	
4	o/w: Social security fund	
5	o/w: Extra budgetary funds (EBFs)	
6	Guarantees (to other entities in the public and private sector, including to SOEs)	X
7	Central bank (borrowed on behalf of the government)	X
8	Non-guaranteed SOE debt	

2. **A stress test for the combined contingent liability shock uses the default setting for SOE debt.** There are no explicit contingent liabilities. The standard contingent liability stress test amounts to 7 percent of GDP, which comprises 2 percent of GDP of non-guaranteed SOE debt and 5 percent of potential liabilities stemming from the financial system. The information regarding a prospective loan by the central government for the installation of cell phone towers across the country has been incorporated into the baseline and a customized fiscal risk scenario.

Text Table 2. Public Debt Coverage and the Magnitude of the Contingent Liability Tailored Stress Test

1	The country's coverage of public debt	The central government, central bank, government-guaranteed debt		
		Default	Used for the analysis	Reasons for deviations from the default settings
2	Other elements of the general government not captured in 1.	0 percent of GDP	0	
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2 percent of GDP	2	
4	PPP	35 percent of PPP stock	0	PPP capital stock data is not available.
5	Financial market (the default value of 5 percent of GDP is the minimum value)	5 percent of GDP	5	
	Total (2+3+4+5) (in percent of GDP)		7.0	

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

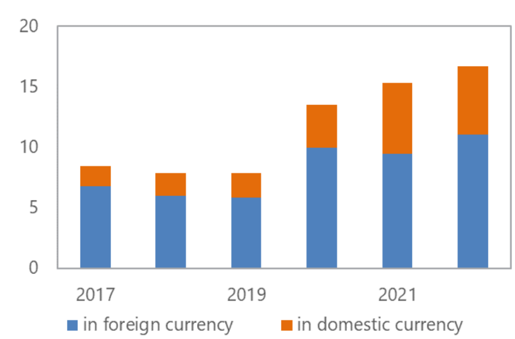
BACKGROUND ON DEBT

3. **Public and Publicly Guaranteed (PPG) external debt stood at US$148.3 million (9.5 percent of GDP) as of end-2021 (latest available full year data), a decline of 0.4 percent of GDP from 2020 (Table 1).** The Asian Development Bank (ADB) and the International Development Association (IDA) remained the largest creditors, accounting for 78 percent of total external debt. The increase in public external debt was mainly due to new external borrowing from Japan International Cooperation Agency (JICA) in the second quarter of 2021 that explained 15 percent of total PPG external debt at end-2021. Private sector external debt amounted to 1.1 percent of GDP at end-2021.

4. **Public debt was 15.4 percent of GDP as of end-2021, an increase of 1.8 percent of GDP from 2020 (Table 2).** Public domestic debt increased to SI$747.8 million (5.9 percent of GDP) at end-2021. Negative real GDP growth, increases in primary expenditures, and declines in revenues after the COVID-19 pandemic accounted for the pick-up in debt. As part of the COVID-19 response, the government issued domestic Development Bonds in 2020-22 purchased by the Solomon Islands National Provident Fund (NPF), the Electricity Authority, and the Port Authority.[2] The stock of Development Bonds rose from SI$360 million at the end of 2020 to SI$650 million at the end of 2021, as the Central Bank of Solomon Islands (CBSI) tripled its purchase of the Development Bonds in the secondary market. The CBSI started its bond purchase to mitigate the impacts of the pandemic, with the initial purchase of SI$60 million in December 2020, followed by additional purchases of SI$180 million in 2021. One commercial bank also holds some of the bonds. An accumulation of domestic payment arrears (estimated at SI$95.8 million in 2021, 0.8 percent of GDP) also contributed to the rise in domestic debt, although the government started clearing the arrears in the second half of 2022.

5. **Both public domestic and external borrowings are expected to grow over the medium term.** The Debt Management Act currently sets a limit for the public debt-to-GDP ratio at 35 percent in nominal terms, which provides an anchor for an annual domestic borrowing limit set in the annual budgets and used as direct guidance for the Debt Management office operations. The limit was raised in 2022 to SI$850 million from SI$350 million in the previous year to accommodate the outstanding stock of the Development Bonds. It was further increased to SI$865 million under the 2023 budget, to accommodate the increased spending on the 2023 Pacific Games and preparation for the general elections scheduled for early 2024. The preliminary outcome for 2022 suggests that domestic borrowing during the year remained under the threshold, at SI$739 million.

Text Figure 1. Public Debt Composition, 2017-22
(in percent of GDP)



[2] Since 2017, the government has started issuing Development Bonds under negotiated private placements with SOEs and the NPF. Recently, they have had a 10-year maturity (3-year grace period) and 5 percent coupon.

Text Table 3. Public Debt: Share by Creditor (percent), 2018-21

	2018	2019	2020	2021
Multilateral Creditor	**69.0**	**69.0**	**65.4**	**48.8**
ADB	36.8	36.2	36.4	27.1
IDA	28.6	29.5	26.6	20.0
Other multilayeral	3.7	3.3	2.5	1.8
Bitelateral Creditor	**6.8**	**5.6**	**3.5**	**11.5**
China Exim Bank	6.8	5.6	3.5	2.2
JICA	0.0	0.0	0.0	9.3
Government Securities	**23.7**	**24.9**	**30.8**	**39.4**
Short Term	5.9	8.2	6.0	4.9
Medium and Long Term	17.7	16.8	24.8	34.5
Total Central Government Debt	**100.0**	**100.0**	**100.0**	**100.0**

6. **As part of the World Bank's Sustainable Development Finance Policy (SDFP), the country satisfactorily implemented the FY21 and FY22 Performance and Policy Actions (PPAs) and is expected to meet FY23 PPAs to improve fiscal sustainability and debt management**. The Government has submitted the Tax Administration Bill to Parliament and approved the Government Bond Operational Guidelines in 2022. As FY23 PPAs, Cabinet is expected to approve a Value Added Tax (VAT) Bill while the government remains committed to adhere to a zero ceiling for non-concessional external borrowing.

COUNTRY CLASSIFICATION

7. **Solomon Islands' debt-carrying capacity remains weak.** The Composite Indicator (CI) index is 2.59, indicating that the debt-carrying capacity continues to be assessed to be weak under the LIC-DSF; the classification is unchanged from the previous published DSA (2021).

8. **Based on the CI rating, Solomon Islands' debt is assessed against the following thresholds:** the benchmark of 35 percent for the PV of public debt-to-GDP ratio and the thresholds of 30 percent for the PV of PPG external debt-to-GDP ratio, 140 percent for the PV of PPG external debt-to-exports ratio, 10 percent for the PPG external debt service-to-exports ratio, and 14 percent for the PPG external debt service-to-revenue ratio.

Text Table 4. Debt Carrying Capacity and Applicable Thresholds

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	2.933	1.13	44%
Real growth rate (in percent)	2.719	1.039	0.03	1%
Import coverage of reserves (in percent)	4.052	57.963	2.35	91%
Import coverage of reserves^2 (in percent)	-3.990	33.597	-1.34	-52%
Remittances (in percent)	2.022	1.433	0.03	1%
World economic growth (in percent)	13.520	2.898	0.39	15%
CI Score			2.59	100%
CI rating			Weak	

Applicable thresholds

APPLICABLE	
EXTERNAL debt burden thresholds	
PV of debt in % of	
Exports	140
GDP	30
Debt service in % of	
Exports	10
Revenue	14

APPLICABLE	
TOTAL public debt benchmark	
PV of total public debt in percent of GDP	35

METHODOLOGY AND ASSUMPTIONS

A. The Baseline

9. **An economic recovery in Solomon Islands is currently under way after a combination of adverse shocks.** The economy was hit by multiple shocks including civil unrest in the capital in November 2021, a local outbreak of COVID-19 in early 2022, and the ongoing spike in food and fuel prices caused by Russia's war in Ukraine. Solomon Islands reopened its border in July 2022 after over two years of isolation and has two important events coming up—the Pacific Games in November 2023 and the general elections in early 2024.

10. **Solomon Islands is now at a critical juncture, as its large pipeline of externally financed infrastructure projects provides a valuable opportunity for growth, but at the same time poses significant macroeconomic costs and risks.** Annual inflation accelerated sharply, from a negative level in March 2022 to 9.9 percent in September, initially driven by higher import prices, followed by passthrough to domestic prices. Higher import prices are expected to have significantly widened the current account deficit to 13.3 percent of GDP in 2022, reducing reserve coverage to 9.5 months of imports. The delayed passing of the 2022 Budget and a late disbursement of budget support grant from a development partner appear to have resulted in an under-implementation of the 2022 budget, with the overall deficit estimated at 4.1 percent of GDP. A draw-down of government

deposits (by an estimated SI$300 million) helped finance the deficit and kept public debt from further rising.

11. The assumptions in the baseline scenario are consistent with the macroeconomic framework. The discount rate used to calculate the net present value of external debt remains at 5 percent. The main assumptions are:

- **Real GDP** is expected to have declined by 4.1 percent in 2022, owing to a series of negative shocks including the end-2021 social unrest, COVID-19-related mobility restrictions, and Russia's war in Ukraine. The growth rate is projected to recover to 2.5 percent in 2023 driven by the Pacific Games and other ongoing large infrastructure projects and remain positive but somewhat below its pre-pandemic level over the medium-term, averaging 2.3 percent during 2022–32. This outlook is premised on large infrastructure projects coming to fruition, expansion of the mining and tourism sectors, some productivity gains in agriculture and fisheries, and increasing young population entering the labor force including in foreign markets.

- **Inflation** (measured by the GDP deflator) is expected to rise to 7.7 percent in 2022 driven by higher global commodity prices and average 3.8 percent during 2022–32.

- **Non-interest current account deficit** is projected to widen to 13.2 percent of GDP in 2022 from 4.9 percent of GDP in 2021 and remain large averaging 8.4 percent of GDP over 2022–32, driven by higher import prices coupled with projected trend declines in logging exports as well as high imports for infrastructure projects. Increasing tourism receipts are forecast to partially offset the deficit. Official grants are projected to decline to 5.5 percent of GDP in 2022 from 6.7 percent of GDP in 2021 and average 2.4 percent of GDP over 2022-32, while FDI inflows, some of which are associated with the current infrastructure investments, are projected to remain steady averaging 2.4 percent of GDP over 2022-32.

- **Fiscal outlook**: A fall in revenue and an increase in pandemic-related spending further widened the primary deficit to 3.8 percent of GDP in 2022, financed by grants, concessional loans, and the issuance of Development Bonds. The government also accumulated payment arrears of around 0.8 percent of GDP in 2020-21, but made progress in 2022 to clear about a quarter of them and set out a path to clear the remaining ones, including by delaying a capital spending project. Fiscal deficits are expected to persist going forward, reflecting large spending needs to achieve Sustainable Development Goals, sizeable costs to maintain the newly built infrastructure, and continued weak revenue trends including from declining revenue from logging exports. The primary deficits are projected to remain elevated at a ten-year average of 2.9 percent of GDP as compared to its historical ten-year average of 0.3 percent of GDP surplus. Efforts to strengthen domestic resource mobilization, such as a planned VAT introduction, improved tax administration through the implementation of the recent Tax Administration Act, and further tax reforms including on mineral taxes would contribute to reducing primary deficits and improving debt dynamics.

- **External and domestic financing**: New on-budget[3] external loan disbursements for projects in the pipeline are expected to remain around 2 percent of GDP over the next five years (2022–27), gradually declining to average 1.1 percent of GDP in the following five-year period (2028-32), under the annual borrowing limits set in the annual budgets. All external financing provided by multilateral institutions (e.g., IDA and ADB) and development partners (e.g., JICA and China ExIm Bank) is assumed to be concessional with the average grant element of new borrowing of at least 36.6 percent. It is assumed that the government will increase its annual T-bill issuance, while gradually shifting the domestic debt profile to Development Bonds in line with the Medium-term Debt Management Strategy[4], to finance the persistent primary deficits as donor support declines. The redemption profile of domestic debt reflects the rollover of medium- and long-term debt as well as T-bills every year. A shift from external concessional borrowing to domestic financing is expected to significantly increase the debt service costs. It will also bring about serious risks stemming from the low absorptive capacity of the domestic bond market, such as crowding out of private investment and destabilized economic and financial environments, in addition to elevated risks for government financing.

Text Table 5. DSA Key Macroeconomic Assumptions

	Previous DSA		Current DSA		Current vs. Previous	
	2021-26	2021-31	2021-26	2021-31	2021-26	2021-31
Real GDP growth, percent	2.5	2.8	1.1	2.0	-1.4	-0.8
Inflation (GDP deflator), percent	4.3	4.1	3.8	3.6	-0.5	-0.5
(In percent of GDP)						
Revenue and grants	29.8	29.3	26.6	26.5	-3.2	-2.8
Primary expenditure	32.9	32.6	30.3	29.5	-2.6	-3.1
Primary balance	-3.1	-3.3	-3.7	-3.0	-0.6	0.3
Exports of goods and services	25.6	23.3	26.4	24.8	0.8	1.5
Imports of goods and services	40.1	37.9	43.3	40.4	3.2	2.5
Non-interest current account balance	-9.5	-9.8	-9.6	-8.2	-0.1	1.6

12. The realism tools[5] suggest that the macroeconomic and fiscal assumptions are reasonable. The external and public PPG debt trajectory in the current DSA is largely in line with the previous DSA (Figure 3) but shows a faster transition to a larger share of domestic debt, reflecting projected declines in external grants for budget support and concessional loans for infrastructure projects. The projected 5-year increases in external and public debt stocks are in line with the respective

[3] A large amount of externally funded investment projects are conducted off budget. See the World Bank's 2022 Public Expenditure Review for Solomon Islands, Chapter 7.

[4] The authorities are working to develop a domestic bond market including through the introduction of auctions for bonds and the expansion of investor base.

[5] The lack of reliable public investment data precludes the team from using the Public Investment-Growth realism tool.

historical ones: public debt is forecast to significantly increase driven by persistent primary deficits, while increases in external debt would be mostly offset by the drawdown of foreign reserves[6] (middle charts). The projected fiscal adjustment over 2022-24 lies in the middle of the distribution of LIC's past adjustment episodes (Figure 4, left). Staff's real GDP growth projection during the years 2022–24 has a more pronounced downturn and recovery due to temporary COVID19-related restrictions and border closures than would have been suggested by fiscal multiplier-based analysis alone (Figure 4, right).

B. Tailored Stress Test[7]

13. Given the severity and frequency of natural disasters in Solomon Islands, the natural disaster shock is tailored to better reflect country-specific factors. Solomon Islands, which is defined as small developing natural disaster-prone state, is automatically subject to the standard natural disaster shock.[8], [9] The default parameter setting was modified to reflect Solomon Islands-specific factors based on the findings of staff's research on the impact of natural disasters.[10] The study is based on EM-DAT, an international disaster database, which shows that historically the largest damage from natural disasters during 1980–2016 was estimated at 14 percent of GDP. A tailored stress test captures a one-off shock to public debt-to-GDP ratio in a similar scale to the largest historical shock, associated with reductions in real GDP growth and exports by 2.7 and 8.1 percentage points, respectively.

C. Customized Fiscal and Financial Risk Scenario

14. A separate customized fiscal and financing risk scenario (Table 5) is added to flag potential risks from mismanagement of externally financed infrastructure projects and possible declines in concessional financing. This risk scenario assumes a materialization of a contingent liability in 2024 from some of the recent infrastructure loans. The size of the shock is presumed to be 7 percent of GDP as under the built-in contingent liability shock. The scenario further assumes an increase in public spending over 2023-28, including driven by cost overruns and surges in maintenance costs of infrastructure projects[11]. It is assumed that additional financing needs be covered through a shift to a combination of

[6] The drawdown of foreign reserves is included in the negative residual in the upper middle chart of Figure 3 that shows contributions to external debt as a percent of GDP.

[7] Six standardized stress tests in the DSF are applied to both external and public DSA. They capture shocks to real GDP growth, the primary fiscal balance, exports, other flows (including official and private transfers and FDI), exchange rate depreciation, and a combination of these shocks.

[8] The IMF board paper, "Small States' Resilience to Natural Disasters and Climate Change – Role for the IMF", 2016.

[9] One-off shock of 10 percentage points of GDP to debt-GDP ratio in the second year of the projection period (2023 in this case). Real GDP growth and exports are lowered by 1.5 and 3.5 percentage points, respectively, in the year of the shock.

[10] Please see the details in the IMF Working paper 18/108, "The Economic Impact of Natural Disaster in Pacific Island Countries."

[11] The World Bank's 2022 Public Expenditure Review for Solomon Islands estimates the potential maintenance costs of the newly built infrastructure at some 2.4 percent of GDP per year.

non-concessional external and domestic financing, which implies a further shortening of maturities, increases in borrowing costs, and some decumulation of government cash reserves.

DEBT SUSTAINABILITY

A. External Debt Sustainability Analysis

15. Under the baseline scenario, all external PPG debt indicators remain below the policy relevant thresholds for the next ten years (Figure 1). The PV of PPG external debt-to-GDP ratio is expected to peak at 13.0 percent in 2025, before trending down to 10.5 percent in 2032. As Figure 3 shows, the main driver of debt dynamics is a deterioration of the current account balance and an increase in foreign direct investment (FDI), which is largely offset by declining foreign reserves.

16. The standardized stress test shows that an export shock has the largest negative impact on the external debt trajectory.[12] With the export shock, the PV of PPG external debt-to-exports ratio is expected to breach the indicative threshold in 2024 (Table 3). This emphasizes the need to expand the export base, as logging activity is expected to substantially decline in the medium term. Other shocks, including to real GDP growth, primary balance, other flows, and commodity prices, do not lead to breaches.

17. A tailored natural disaster shock causes all the debt trajectories for each debt indicator to move upward. Though the DSA assumes a one-off shock that takes place in 2023, there is a possibility that multiple severe natural disasters could occur within a 10-year timeframe. Staff's work shows that there is a probability of around 13.5 percent of a disaster each year of a magnitude of more that 3 percent of GDP or impacting 5 percent of the population. Multiple natural disasters would have a larger cumulative effect on debt sustainability through lower long-term growth and higher borrowing needs for post-disaster reconstruction efforts.

B. Public Sector Debt Sustainability Analysis

18. Under the baseline scenario, the PV of public debt-to-GDP ratio is forecast to get close to the 35 percent benchmark towards the end of the 10-year projection horizon (Figure 2). The ratio is projected to rise from 16.3 percent in 2022 to 34.0 percent in 2032. In nominal terms, the ratio of public debt-to-GDP is projected to breach the authorities' policy threshold of 35 percent in 2031, reflecting persistent primary deficits despite the sizeable projected nominal GDP growth. Both the PV of public debt-to-revenue and grants ratio and debt service-to-revenue and grants ratio are forecast to more than double in the coming decade. The major driver of the rising debt ratios is the projected decline in external budget support grants coupled with shifts from highly concessional external debt to more expensive domestic borrowing.

[12] The export shock sets nominal export growth (in USD) to its historical average minus one standard deviation (SD), or the baseline projection minus one SD, whichever is lower in the second and third years of the projection period.

19. The sensitivity analysis highlights vulnerabilities of Solomon Islands' public debt. The 35 percent benchmark for the PV of public debt as percent of GDP would be breached under various shock scenarios (Figure 2, Table 4). The PV of debt-to-revenue ratio is most affected by the commodity price shock. As a small exporter of multiple commodities that now include gold, the country is highly exposed to international price fluctuations and Chinese market demand for logs which is expected to slowdown in line with the downward revision of China's potential growth. The country's high vulnerabilities to shocks highlight the need for economic diversification and fostering growth of the non-commodity private sector over the medium term.

20. The natural disaster shock scenario flags major risks to debt sustainability. In the natural disaster shock scenario, the PV of public debt-to-GDP ratio would breach the 35 percent benchmark in 2026. This result highlights the importance of rebuilding fiscal buffers against external shocks including natural disasters.

21. The fiscal and financing risk scenario highlights the critical importance of prudent public investment management and Solomon Islands' vulnerability to financing terms. Under the scenario, the PV of public debt-to-GDP ratio is projected to breach the 35 percent benchmark immediately in 2024. Public investment projects need to be phased in line with the economy's absorptive capacity and accompanying financing arrangements should be carefully negotiated, to mitigate fiscal risks and ensure debt sustainability.

RISK RATING AND VULNERABILITIES

22. The 2022 debt sustainability analysis suggests that Solomon Islands' risk of external debt distress is moderate. All debt indicators remain below the relevant thresholds in 2022-32 under the baseline scenario. Several shocks would result in a significant deterioration in debt sustainability. Even though debt service indicators are below their thresholds, maximizing concessional loans would help keep the debt burden contained. Bringing more of the off-budget donor financing on budget could help increase fiscal space and improve debt sustainability indicators.

23. The moderate risk tool for external debt (Figure 5) suggests that there is a substantial space to absorb shocks. It reflects a current low level of external debt.[13] However, the decline in government cash balance and constraints to absorptive capacity call for caution in debt accumulation.

[13] The space is measured by the distance between the baseline debt burden indicators and their thresholds.

24. Stress tests highlight vulnerabilities of Solomon Islands. Various scenarios including commodity price and natural disaster shocks would significantly worsen public debt sustainability, on the back of the projected widening of fiscal deficits. And so will the alternative fiscal and financing risk scenario. These vulnerabilities call for measures to rebuild fiscal buffers, boost medium-term potential growth, and prioritize investment projects that build resilience to natural disasters. Prudent public investment management including its financing terms is also critically important.

25. The public debt portfolio faces limited refinancing and interest rate risks.[14] About 76 percent of public debt is external loans that are contracted at highly concessional terms.[15] There is rollover risk associated with T-bills (which account for about 17 percent of domestic debt) but the risk is limited given excess market liquidity and high market demand for government securities. Given high liquidity in the banking system, yields of government securities have remained broadly constant over the past years. This is the case for both T-bill auctions (e.g. yields for one-year T-bills have amounted to around 1.1 percent) and the negotiated coupon rate on the Development Bonds, thereby limiting interest rate risk.

AUTHORITIES' VIEWS

26. The authorities broadly agreed with staff's analysis of Solomon Islands' debt sustainability. They underscored their firm commitment to the Medium-term Debt Management Strategy, including increasing the share of financing from the domestic debt market, as well as their intention to manage public debt within the 35 percent of GDP threshold in the medium-term. They aim to gradually rebuild the cash balance and lower fiscal deficits while addressing huge investment needs for infrastructure and human capital development, through improving the efficiency of spending and advancing domestic revenue mobilization. The authorities are committed to prudent management of infrastructure projects and assessment of the terms of external borrowing to ensure macroeconomic stability and debt sustainability.

[14] More details are presented in the World Bank and the IMF TA report "Solomon Islands: Medium-term Debt Management Strategy Mission", July 2021.

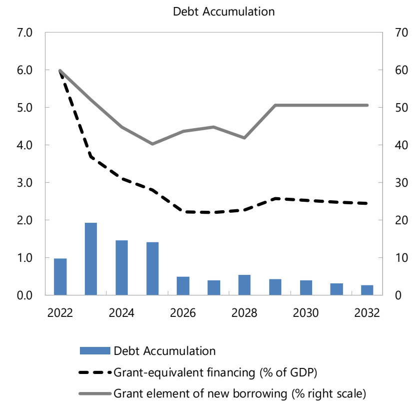
[15] The Average Time To Maturity (ATM) for external (domestic) debt is 13.6 (6.2) years. The weighted average interest rate is 1 percent for external loans and borrowing costs for domestic debt is relatively low and stable at 4.9 percent.

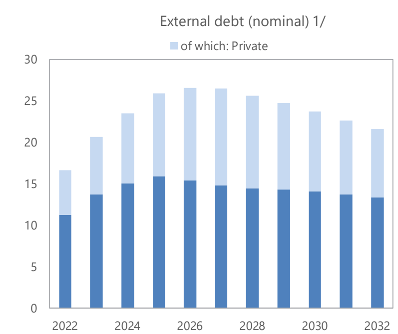
Table 1. Solomon Islands: External Debt Sustainability Framework, Baseline Scenario, 2019–42

(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/	
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2032	2042	Historical	Projections
External debt (nominal) 1/	8.7	13.1	12.7	16.6	20.7	23.5	25.9	26.6	26.4	21.6	12.9	11.1	23.4
of which: public and publicly guaranteed (PPG)	5.8	9.9	9.5	11.2	13.7	15.0	15.9	15.4	14.8	13.3	8.8	8.3	14.2
Change in external debt	1.9	4.4	-0.4	3.9	4.0	2.8	2.4	0.7	-0.1	-1.0	-1.0		
Identified net debt-creating flows	7.7	1.7	3.5	11.3	9.8	7.3	6.7	4.8	4.1	4.2	2.4	1.1	5.7
Non-interest current account deficit	9.4	1.5	4.9	13.2	12.5	10.0	9.6	7.6	6.9	6.9	4.4	3.3	8.4
Deficit in balance of goods and services	10.0	8.3	13.3	21.0	18.4	17.2	16.6	14.7	14.0	14.8	12.0	7.5	15.7
Exports	36.5	27.9	26.8	24.4	29.3	27.3	25.8	25.0	24.6	20.0	13.4		
Imports	46.5	36.2	40.1	45.4	47.8	44.5	42.5	39.6	38.6	34.8	25.3		
Net current transfers (negative = inflow)	-1.5	-4.3	-7.1	-5.8	-4.2	-5.5	-5.3	-5.5	-5.5	-6.0	-6.2	-5.7	-5.5
of which: official	-3.6	-4.7	-6.7	-5.5	-2.5	-2.6	-2.1	-2.2	-1.9	-1.9	0.0		
Other current account flows (negative = net inflow)	0.9	-2.5	-1.3	-2.1	-1.7	-1.7	-1.8	-1.6	-1.7	-1.9	-1.3	1.5	-1.8
Net FDI (negative = inflow)	-1.8	-0.4	-1.5	-2.5	-2.5	-2.4	-2.4	-2.4	-2.4	-2.3	-1.8	-1.9	-2.4
Endogenous debt dynamics 2/	0.1	0.6	0.1	0.6	-0.2	-0.3	-0.4	-0.5	-0.4	-0.4	-0.2		
Contribution from nominal interest rate	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.3	0.3	0.3	0.2		
Contribution from real GDP growth	-0.1	0.3	0.1	0.5	-0.4	-0.5	-0.7	-0.7	-0.8	-0.7	-0.4		
Contribution from price and exchange rate changes	0.1	0.2	-0.1	...	...	...	...	...	...	...	...		
Residual 3/	-5.8	2.7	-3.9	-7.4	-5.7	-4.5	-4.3	-4.1	-4.2	-5.3	-3.4	-1.9	-4.9
of which: exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	...	...	10.0	10.6	11.8	12.5	13.0	12.7	12.3	10.5	6.3		
PV of PPG external debt-to-exports ratio	...	...	37.2	43.4	40.0	45.6	50.5	51.0	50.3	52.5	47.4		
PPG debt service-to-exports ratio	1.4	1.6	1.6	1.7	1.4	1.8	2.4	2.4	2.5	3.9	3.9		
PPG debt service-to-revenue ratio	2.0	1.8	1.9	1.8	1.8	2.0	2.5	2.4	2.5	3.2	2.3		
Gross external financing need (Million of U.S. dollars)	132.8	25.5	60.5	177.8	178.4	146.0	149.9	120.0	112.5	163.0	188.5		
Key macroeconomic assumptions													
Real GDP growth (in percent)	1.7	-3.4	-0.6	-4.1	2.5	2.4	3.0	3.0	3.0	3.1	3.3	1.9	2.3
GDP deflator in US dollar terms (change in percent)	-1.5	-1.8	1.1	7.7	4.0	3.4	3.4	3.2	3.2	3.6	5.1	2.2	3.8
Effective interest rate (percent) 4/	1.8	1.3	1.0	1.1	1.0	1.0	1.1	1.1	1.3	1.4	1.8	1.8	1.2
Growth of exports of G&S (US dollar terms, in percent)	-13.1	-27.5	-3.5	-5.9	28.2	-1.4	0.7	2.7	4.6	1.7	3.6	-1.8	3.7
Growth of imports of G&S (US dollar terms, in percent)	0.6	-26.1	11.3	17.0	12.2	-1.3	1.6	-0.8	3.5	4.9	5.6	0.8	5.0
Grant element of new public sector borrowing (in percent)	...	...	...	59.7	52.0	44.8	40.2	43.6	44.7	50.5	50.5	...	48.1
Government revenues (excluding grants, in percent of GDP)	25.8	24.6	22.6	23.0	23.0	24.3	25.0	24.8	24.7	24.1	23.1	27.9	24.2
Aid flows (in Million of US dollars) 5/	119.9	213.0	213.2	109.2	92.2	79.4	71.8	47.5	50.0	78.2	127.5		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	6.0	3.7	3.1	2.8	2.2	2.2	2.4	2.1	...	2.9
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	87.4	68.0	70.2	67.3	83.2	85.1	82.6	88.8	...	78.9
Nominal GDP (Million of US dollars)	1,619	1,536	1,545	1,596	1,701	1,801	1,919	2,039	2,169	2,989	5,914		
Nominal dollar GDP growth	0.2	-5.1	0.6	3.3	6.6	5.9	6.5	6.3	6.4	6.8	8.6	4.1	6.2
Memorandum items:													
PV of external debt 7/	...	...	13.2	16.0	18.7	21.0	23.0	23.9	24.0	18.8	10.4		
In percent of exports	...	...	49.4	65.7	63.7	76.7	89.0	95.9	97.8	93.8	77.9		
Total external debt service-to-exports ratio	1.6	1.9	1.8	1.9	1.6	2.0	2.7	2.7	2.8	4.3	4.5		
PV of PPG external debt (in Million of US dollars)			154.0	169.0	199.9	224.8	250.2	259.6	267.6	313.9	375.0		
(PVt-PVt-1)/GDPt-1 (in percent)				1.0	1.9	1.5	1.4	0.5	0.4	0.3	0.1		
Non-interest current account deficit that stabilizes debt ratio	7.4	-2.9	5.3	9.3	8.4	7.2	7.2	6.9	7.0	7.9	5.3		

Definition of external/domestic debt	Residency-based
Is there a material difference between the two criteria?	Yes





Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g) + Ɛα (1+r)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, ρ = growth rate of GDP deflator in U.S. dollar terms, Ɛ=nominal appreciation of the local currency, and α= share of local currency-denominated external debt in total external debt.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Current-year interest payments divided by previous period debt stock.

5/ Defined as grants, concessional loans, and debt relief.

6/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

7/ Assumes that PV of private sector debt is equivalent to its face value.

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

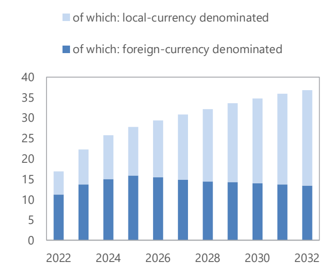
Table 2. Solomon Islands: Public Sector Debt Sustainability Framework, Baseline Scenario, 2019–42

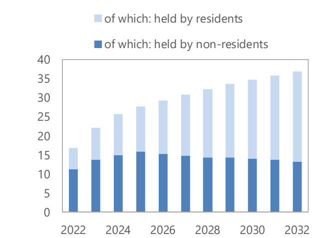
(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2032	2042	Historical	Projections
Public sector debt 1/	7.9	13.5	15.4	16.9	22.2	25.7	27.8	29.3	30.8	36.8	42.1	**10.8**	**29.6**
of which: external debt	5.8	9.9	9.5	11.2	13.7	15.0	15.9	15.4	14.8	13.3	8.9	**8.3**	**14.2**
Change in public sector debt	0.0	5.6	1.8	1.5	5.3	3.6	2.0	1.6	1.5	1.0	0.0		
Identified debt-creating flows	1.3	2.7	3.6	3.7	5.0	3.4	2.0	1.9	1.8	1.3	0.3	**-0.6**	**2.3**
Primary deficit	1.4	2.2	3.4	3.8	5.8	4.0	2.7	2.6	2.4	1.9	1.0	**-0.3**	**2.9**
Revenue and grants	27.4	30.1	27.1	27.7	24.8	26.4	26.9	26.7	26.6	26.0	24.9	**31.8**	**26.4**
of which: grants	1.6	5.5	4.5	4.7	1.8	2.0	1.9	1.9	1.9	1.9	1.8		
Primary (noninterest) expenditure	28.8	32.4	30.5	31.5	30.7	30.4	29.6	29.3	29.0	27.9	25.8	**31.4**	**29.3**
Automatic debt dynamics	-0.1	0.5	0.2	-0.2	-0.8	-0.6	-0.7	-0.7	-0.6	-0.6	-0.6		
Contribution from interest rate/growth differential	-0.2	0.4	-0.1	-0.2	-0.8	-0.6	-0.7	-0.7	-0.6	-0.6	-0.6		
of which: contribution from average real interest rate	0.0	0.1	-0.2	-0.8	-0.4	-0.1	0.0	0.1	0.3	0.5	0.7		
of which: contribution from real GDP growth	-0.1	0.3	0.1	0.7	-0.4	-0.5	-0.8	-0.8	-0.9	-1.1	-1.3		
Contribution from real exchange rate depreciation	0.1	0.0	0.4	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	**0.0**	**0.0**
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (e.g. IMF loan)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	-1.3	2.9	-1.8	-2.2	0.3	0.2	0.0	-0.3	-0.3	-0.3	-0.3	**0.3**	**-0.3**
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	...	...	15.7	16.3	20.2	23.2	24.9	26.7	28.3	34.0	39.6		
PV of public debt-to-revenue and grants ratio	...	...	58.1	59.0	81.5	88.1	92.6	99.9	106.5	130.9	158.9		
Debt service-to-revenue and grants ratio 3/	3.1	3.6	4.9	4.6	3.1	4.7	6.0	6.1	7.9	10.9	17.2		
Gross financing need 4/	2.2	3.3	4.7	5.1	6.6	5.2	4.3	4.1	4.4	4.7	5.2		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	1.7	-3.4	-0.6	-4.1	2.5	2.4	3.0	3.0	3.0	3.1	3.3	**1.9**	**2.3**
Average nominal interest rate on external debt (in percent)	1.5	1.2	0.8	0.9	1.0	1.1	1.2	1.3	1.8	1.8	1.7	**1.1**	**1.5**
Average real interest rate on domestic debt (in percent)	-1.0	7.0	3.5	-4.0	-1.6	0.5	1.1	1.7	2.0	2.2	2.4	**-1.3**	**1.0**
Real exchange rate depreciation (in percent, + indicates depreciation)	1.4	0.8	4.0	...	...	...	...	...	...	...	...	**0.2**	**...**
Inflation rate (GDP deflator, in percent)	1.2	-1.3	1.1	7.0	4.7	3.4	3.4	3.2	3.2	3.6	3.5	**2.8**	**3.8**
Growth of real primary spending (deflated by GDP deflator, in percent)	-2.6	8.5	-6.4	-0.8	-0.3	1.6	0.3	1.8	2.0	2.3	2.6	**3.4**	**1.5**
Primary deficit that stabilizes the debt-to-GDP ratio 5/	1.4	-3.4	1.6	2.3	0.5	0.5	0.7	1.0	0.9	0.9	0.9	**-0.2**	**0.9**
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Definition of external/domestic debt	**Residency-based**
Is there a material difference between the two criteria?	**Yes**

Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central government, central bank, government-guaranteed debt . Definition of external debt is Residency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.

4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Table 3. Solomon Islands: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2022–32

(In percent)

	Projections 1/										
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
PV of debt-to GDP ratio											
Baseline	10.6	12	12	13	13	12	12	12	11	11	10.5
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	11	7	5	3	1	-1	-3	-4	-6	-7	-9
A2. Fiscal and Financial Risk Scenario	11	14	17	19	18	18	17	17	16	15	14
B. Bound Tests											
B1. Real GDP growth	11	12	14	14	14	14	13	13	13	12	12
B2. Primary balance	11	13	15	16	15	15	15	14	14	14	13
B3. Exports	11	17	25	25	25	24	24	23	22	22	21
B4. Other flows 3/	11	14	17	18	17	17	16	16	15	15	14
B5. Depreciation	11	15	12	13	12	12	12	11	11	11	10
B6. Combination of B1-B5	11	19	20	21	20	20	19	19	18	18	17
C. Tailored Tests											
C1. Combined contingent liabilities	11	15	16	16	16	16	15	15	14	14	13
C2. Natural disaster	11	19	20	21	21	20	20	20	20	20	19
C3. Commodity price	11	15	19	19	19	18	17	16	15	13	12
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	30	30	30	30	30	30	30	30	30	30	30
PV of debt-to-exports ratio											
Baseline	43	40	46	50	51	50	51	52	52	52	52
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	43	25	18	11	2	-5	-11	-18	-26	-35	-45
A2. Fiscal and Financial Risk Scenario	43	47	61	73	73	72	72	73	73	72	71
B. Bound Tests											
B1. Real GDP growth	43	40	46	50	51	50	51	52	52	52	52
B2. Primary balance	43	45	55	61	62	61	62	63	64	64	65
B3. Exports	43	87	**151**	**162**	**164**	**162**	**163**	**167**	**169**	**170**	**170**
B4. Other flows 3/	43	48	63	68	69	68	69	70	71	71	71
B5. Depreciation	43	40	35	39	39	39	39	40	40	40	40
B6. Combination of B1-B5	43	84	67	109	110	108	109	112	113	113	113
C. Tailored Tests											
C1. Combined contingent liabilities	43	51	58	63	64	63	64	65	66	66	67
C2. Natural disaster	43	66	76	84	86	87	89	92	95	97	101
C3. Commodity price	43	64	84	88	84	78	73	72	69	66	63
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	140	140	140	140	140	140	140	140	140	140	140
Debt service-to-exports ratio											
Baseline	2	1	2	2	2	3	3	3	4	4	4
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	2	1	1	2	2	2	2	3	3	3	2
A2. Fiscal and Financial Risk Scenario	2	1	2	3	4	4	4	5	5	6	6
B. Bound Tests											
B1. Real GDP growth	2	1	2	2	2	3	3	3	4	4	4
B2. Primary balance	2	1	2	3	3	3	3	4	4	4	4
B3. Exports	2	2	4	6	6	6	6	8	8	8	**10**
B4. Other flows 3/	2	1	2	3	3	3	3	4	4	4	5
B5. Depreciation	2	1	2	2	2	2	2	3	3	4	4
B6. Combination of B1-B5	2	2	3	4	4	4	5	6	6	6	8
C. Tailored Tests											
C1. Combined contingent liabilities	2	1	2	3	3	3	3	4	4	4	4
C2. Natural disaster	2	2	2	3	3	3	3	4	5	5	5
C3. Commodity price	2	2	3	4	3	3	3	4	4	4	5
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	10	10	10	10	10	10	10	10	10	10	10
Debt service-to-revenue ratio											
Baseline	2	2	2	2	2	2	2	3	3	3	3
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	2	2	2	2	2	2	1	2	2	2	1
A2. Fiscal and Financial Risk Scenario	2	2	2	3	4	4	4	4	4	5	5
B. Bound Tests	2	2	2	3	4	4	4	4	4	5	5
B1. Real GDP growth	2	2	2	3	3	3	3	4	4	4	4
B2. Primary balance	2	2	2	3	3	3	3	3	3	3	4
B3. Exports	2	2	3	4	4	4	4	4	4	4	5
B4. Other flows 3/	2	2	2	3	3	3	3	4	4	4	4
B5. Depreciation	2	2	2	3	3	3	3	4	4	4	4
B6. Combination of B1-B5	2	2	3	3	3	3	3	4	4	4	5
C. Tailored Tests											
C1. Combined contingent liabilities	2	2	2	3	3	3	3	4	3	4	3
C2. Natural disaster	2	2	3	3	3	3	3	4	4	4	4
C3. Commodity price	2	2	3	4	3	3	3	4	4	4	4
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	14	14	14	14	14	14	14	14	14	14	14

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the threshold.
2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
3/ Includes official and private transfers and FDI.

Table 4. Solomon Islands: Sensitivity Analysis for Key Indicators of Public Debt, 2022–32
(In percent)

	Projections 1/										
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
PV of Debt-to-GDP Ratio											
Baseline	16	20	23	25	27	28	30	31	32	33	34
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	16	17	18	18	19	19	20	20	21	21	21
A2. Fiscal and Financial Risk Scenario	16	24	**37**	**40**	**42**	**44**	**46**	**46**	**47**	**48**	**48**
B. Bound Tests											
B1. Real GDP growth	16	22	28	31	35	**38**	**41**	**44**	**46**	**48**	**50**
B2. Primary balance	16	22	27	28	30	31	33	34	35	**36**	**37**
B3. Exports	16	25	35	**36**	**37**	**39**	**40**	**41**	**42**	**43**	**43**
B4. Other flows 3/	16	23	28	29	31	33	34	**35**	**36**	**37**	**38**
B5. Depreciation	16	21	23	23	24	25	25	25	25	25	25
B6. Combination of B1-B5	16	21	25	25	27	28	30	31	32	33	34
C. Tailored Tests											
C1. Combined contingent liabilities	16	24	27	29	30	32	33	34	**35**	**36**	**37**
C2. Natural disaster	16	30	33	34	**36**	**38**	**40**	**41**	**43**	**44**	**45**
C3. Commodity price	16	23	29	34	**39**	**43**	**46**	**49**	**51**	**53**	**55**
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
TOTAL public debt benchmark	35	35	35	35	35	35	35	35	35	35	35
PV of Debt-to-Revenue Ratio											
Baseline	59	81	88	93	100	106	113	117	122	127	131
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	59	68	67	67	69	72	74	76	77	79	82
A2. Fiscal and Financial Risk Scenario	5	4	9	10	9	10	11	12	12	13	13
B. Bound Tests											
B1. Real GDP growth	59	88	105	115	129	141	153	164	174	184	193
B2. Primary balance	59	88	101	105	112	118	124	128	133	137	141
B3. Exports	59	103	131	134	140	146	151	156	159	163	166
B4. Other flows 3/	59	91	106	110	117	123	129	133	138	142	145
B5. Depreciation	59	87	87	87	90	93	95	96	97	97	98
B6. Combination of B1-B5	59	86	93	92	99	106	111	116	121	125	129
C. Tailored Tests											
C1. Combined contingent liabilities	59	98	103	107	114	120	126	131	135	139	143
C2. Natural disaster	59	119	123	128	136	144	151	156	162	167	172
C3. Commodity price	59	102	121	139	156	168	178	184	194	203	212
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Debt Service-to-Revenue Ratio											
Baseline	5	3	5	6	6	8	9	10	10	11	11
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2022-2032 2/	5	3	3	5	5	7	8	9	10	10	10
A2. Fiscal and Financial Risk Scenario	5	4	9	10	9	10	11	12	12	13	13
B. Bound Tests											
B1. Real GDP growth	5	3	6	7	8	10	11	13	13	14	14
B2. Primary balance	5	3	5	7	6	8	10	11	11	11	11
B3. Exports	5	3	5	7	7	9	10	11	11	12	12
B4. Other flows 3/	5	3	5	6	6	8	10	11	11	11	12
B5. Depreciation	5	3	5	6	6	8	9	10	10	11	10
B6. Combination of B1-B5	5	3	5	6	6	8	9	10	10	11	11
C. Tailored Tests											
C1. Combined contingent liabilities	5	3	7	7	7	8	10	11	11	11	11
C2. Natural disaster	5	3	9	7	7	9	11	12	12	12	12
C3. Commodity price	5	4	6	7	9	11	12	13	13	14	14
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

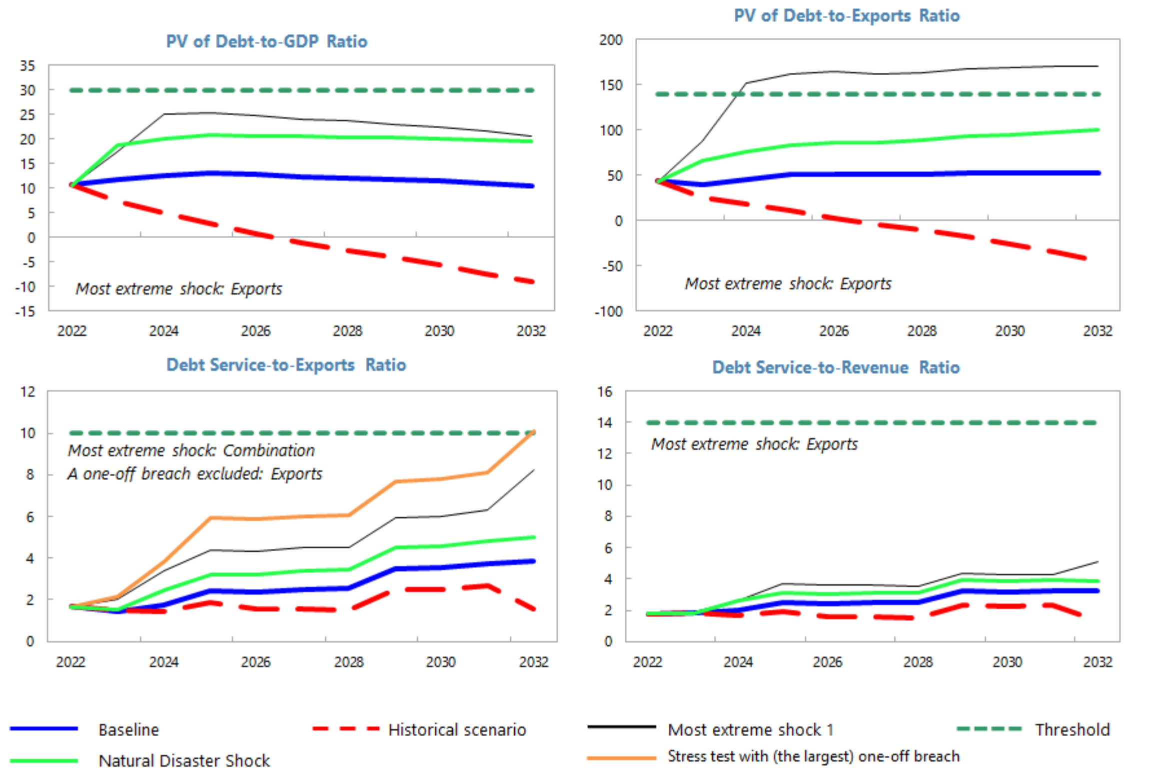
Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the benchmark.
2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.
3/ Includes official and private transfers and FDI.

Table 5. Solomon Islands: Alternative Fiscal and Financial Risk Scenario, 2022–32

(In percent of GDP)

	First year of proj. 2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Public sector debt	**16.9**	**25.8**	**39.3**	**42.3**	**44.2**	**45.5**	**46.4**	**47.4**	**48.1**	**48.7**	**49.3**
of which: foreign-currency denominated	11.1	15.9	19.3	21.3	21.4	21.0	20.4	19.9	18.7	17.5	16.4
PV of public debt-to-GDP ratio	**16.5**	**23.9**	**36.8**	**39.4**	**41.7**	**43.1**	**44.4**	**45.2**	**46.2**	**47.1**	**47.9**
Change in public sector debt	1.9	8.9	13.5	3.0	1.9	1.2	1.0	0.9	0.7	0.6	0.6
Identified debt-creating flows	4.2	8.5	13.2	2.7	2.0	1.3	1.1	1.0	0.8	0.6	0.7
Primary deficit	3.8	8.8	6.5	3.7	3.1	2.4	2.2	2.2	2.1	2.0	2.1
Revenue and grants	27.7	23.8	25.4	26.9	26.7	26.6	26.5	26.4	26.2	26.1	25.8
of which: grants	4.7	0.8	1.0	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.7
Primary (noninterest) expenditure	31.5	32.7	31.9	30.6	29.8	29.0	28.8	28.6	28.4	28.1	27.9
Automatic debt dynamics	0.4	-0.3	-0.4	-1.0	-1.0	-1.1	-1.2	-1.2	-1.3	-1.4	-1.4
Contribution from interest rate/growth differential	-0.2	-0.6	-0.5	-1.1	-1.1	-1.1	-1.1	-1.1	-1.2	-1.2	-1.3
of which: contribution from average real interest rate	-0.8	-0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
of which: contribution from real GDP growth	0.7	-0.4	-0.6	-1.2	-1.2	-1.3	-1.3	-1.4	-1.4	-1.4	-1.5
Contribution from real exchange rate depreciation	0.6	0.3	0.2	0.1	0.1	0.0	-0.1	0.0	-0.1	-0.2	-0.2
Denominator = 1+g	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Other identified debt-creating flows	0.0	0.0	7.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	7.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other debt creating or reducing flow (e.g. IMF loan)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual	-2.3	0.4	0.3	0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Public sector debt-to-revenue-and-grants ratio (in percent)	60.9	108.4	154.9	157.4	165.6	170.7	175.2	179.5	183.3	186.5	191.3
Gross financing need	5.1	9.6	8.5	6.4	5.7	5.5	5.9	6.2	6.2	6.3	6.4
in billions of U.S. dollars	81.1	158.7	145.1	113.6	106.4	107.9	120.3	133.8	141.1	151.7	163.5
Key macroeconomic and fiscal assumptions											
Nominal GDP (local currency)	13020.7	13569.7	14202.5	15015.7	15909.8	16961.4	18122.1	19452.1	20893.9	22495.6	24271.1
Real GDP growth (in percent)	-4.1	2.5	2.4	3.0	3.0	3.0	3.0	3.1	3.1	3.1	3.1
Average nominal interest rate on public debt (in percent)	1.6	1.7	2.5	2.5	2.8	3.2	3.4	3.7	3.8	3.9	4.1
Average nominal interest rate on external debt (in percent)	0.9	1.0	1.5	1.8	2.0	2.3	2.2	2.6	2.3	2.3	2.3
Average nominal interest rate on domestic debt (in percent)	2.7	3.0	4.3	3.1	3.5	4.0	4.3	4.6	4.8	5.0	5.1
Average real interest rate (in percent)	-5.1	-1.4	0.3	0.2	0.4	0.5	0.5	0.5	0.5	0.5	0.5
Average real interest rate on domestic debt (in percent)	-4.0	1.3	2.0	0.5	0.6	0.5	0.6	0.4	0.6	0.5	0.5
Average real interest rate on external debt (in percent)	-5.7	-2.7	-0.7	-0.1	0.1	0.5	0.3	0.7	0.4	0.4	0.4
Exchange rate (LC per US dollar)	8.2	8.2	8.3	8.4	8.5	8.7	8.8	9.0	9.1	9.3	9.4
Nominal depreciation of local currency (percentage change in LC per dollar)	0.9	1.0	1.1	1.2	1.3	1.7	1.5	2.0	1.6	1.6	1.6
Exchange rate (US dollar per LC)	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Nominal appreciation (increase in US dollar value of local currency, in percent)	-0.8	-1.0	-1.1	-1.2	-1.3	-1.7	-1.5	-2.0	-1.6	-1.6	-1.6
Real exchange rate depreciation (in percent, + indicates depreciation)	6.3	3.1	1.1	0.5	0.3	0.1	-0.3	-0.2	-0.6	-0.9	-1.0
Inflation rate (GDP deflator, in percent)	1.6	1.7	2.2	2.6	2.9	3.5	3.7	4.2	4.2	4.4	4.6
US Inflation rate (GDP deflator, in percent)	7.0	3.8	2.2	1.9	1.9	1.8	1.9	1.9	1.9	1.9	1.9
Growth of real primary spending (deflated by GDP deflator, in percent)	4.5	6.2	0.1	-1.2	0.2	0.3	2.2	2.6	2.2	2.2	2.3
Nominal spending	4102.7	4431.4	4530.9	4595.5	4737.3	4918.7	5210.5	5568.4	5927.1	6324.7	6766.4
Increase in percent	6.1	8.0	2.2	1.4	3.1	3.8	5.9	6.9	6.4	6.7	7.0
Increase in real spending in percent	4.5	6.2	0.1	-1.2	0.2	0.3	2.2	2.6	2.2	2.2	2.3
In billions of local currency											
Nominal debt	2194	3502	5584	6353	7040	7711	8415	9219	10055	10953	11966
Total public domestic debt	746	1344	2836	3148	3638	4146	4725	5351	6145	7021	7994
of which: Short term	19	120	134	101	114	120	131	141	163	180	202
Total public external debt	1448	2157	2748	3205	3401	3564	3690	3867	3910	3932	3972
Debt service											
Amortization (excluding ST domestic debt)	41.1	52.2	74.1	126.6	148.7	196.2	275.9	329.6	360.6	398.5	402.6
Interest Expenditure	30.6	36.7	89.3	139.7	174.7	225.6	258.9	311.4	345.9	396.4	450.6
Domestic debt	20.3	22.6	57.1	89.1	111.2	145.8	179.7	216.3	258.0	307.4	360.9
External debt	10.4	14.0	32.1	50.6	63.5	79.7	79.2	95.1	87.9	89.0	89.7
Primary deficit	498.2	1200.3	927.0	558.3	485.3	402.4	406.8	432.0	442.5	452.2	512.1
Gross financing need (in local currency)	662.8	1308.6	1209.9	958.8	909.3	938.2	1061.5	1204.2	1290.4	1410.6	1545.1
PV of public sector external debt (end of period)	1399.2	1902.3	2395.1	2775.2	2989.3	3166.2	3319.1	3447.5	3516.2	3563.1	3628.3
		0.0	0.0	0.0	0.0	0.0	0.0				
Debt service-to-revenue-and-grants ratio (in percent)	4.6	3.4	7.8	9.9	10.0	11.9	13.6	15.0	15.5	16.3	16.5
Debt service-to-GDP ratio (in percent)	1.3	0.8	2.0	2.7	2.7	3.2	3.6	4.0	4.1	4.3	4.3
PV of public debt-to-revenue and grants ratio	59.5	100.5	145.2	146.7	155.9	161.9	167.4	171.3	176.1	180.2	185.8

Figure 1. Solomon Islands: Indicators of Public and Publicly Guaranteed External Debt Under Baseline Scenarios, 2022–32 1/



Customization of Default Settings		
	Size	Interactions
Tailored Stress		
Combined CL	No	
Natural disaster	Yes	Yes
Commodity price 2/	No	No
Market financing	n.a.	n.a.

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing assumptions on additional financing needs resulting from the stress tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	1.3%	1.3%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	35	35
Avg. grace period	8	8

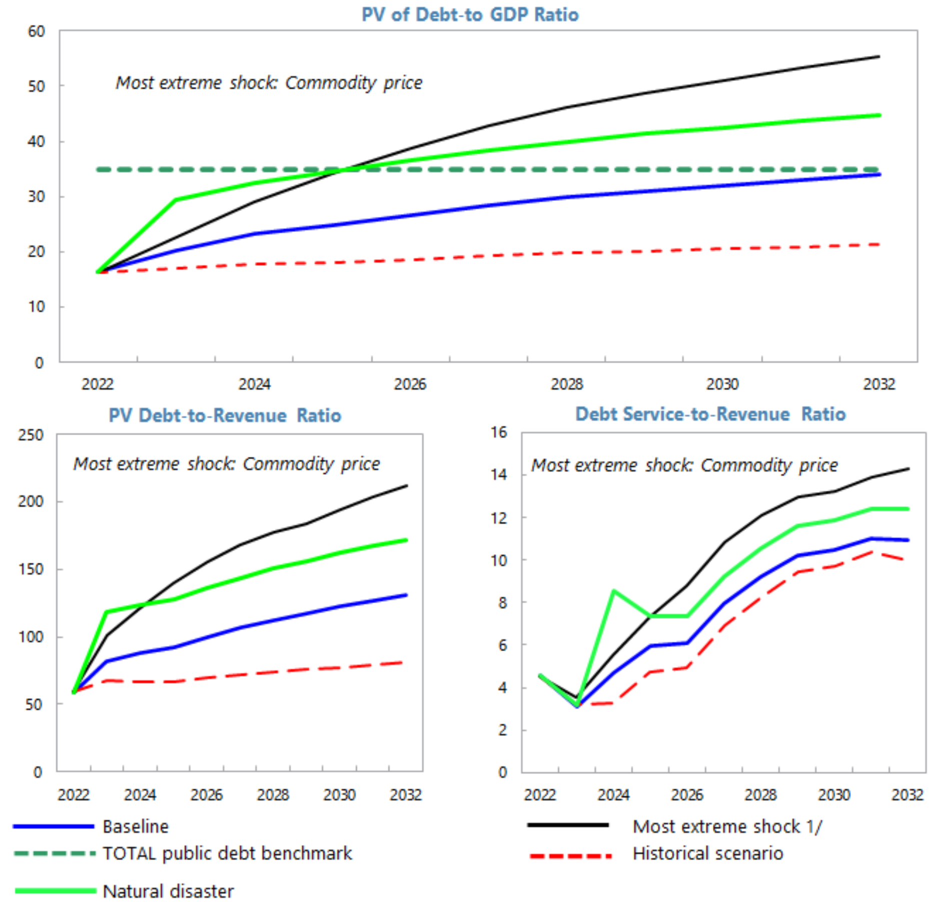
* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2032. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research

Figure 2. Solomon Islands: Indicators of Public Debt Under Baseline Scenarios, 2022–32 1/



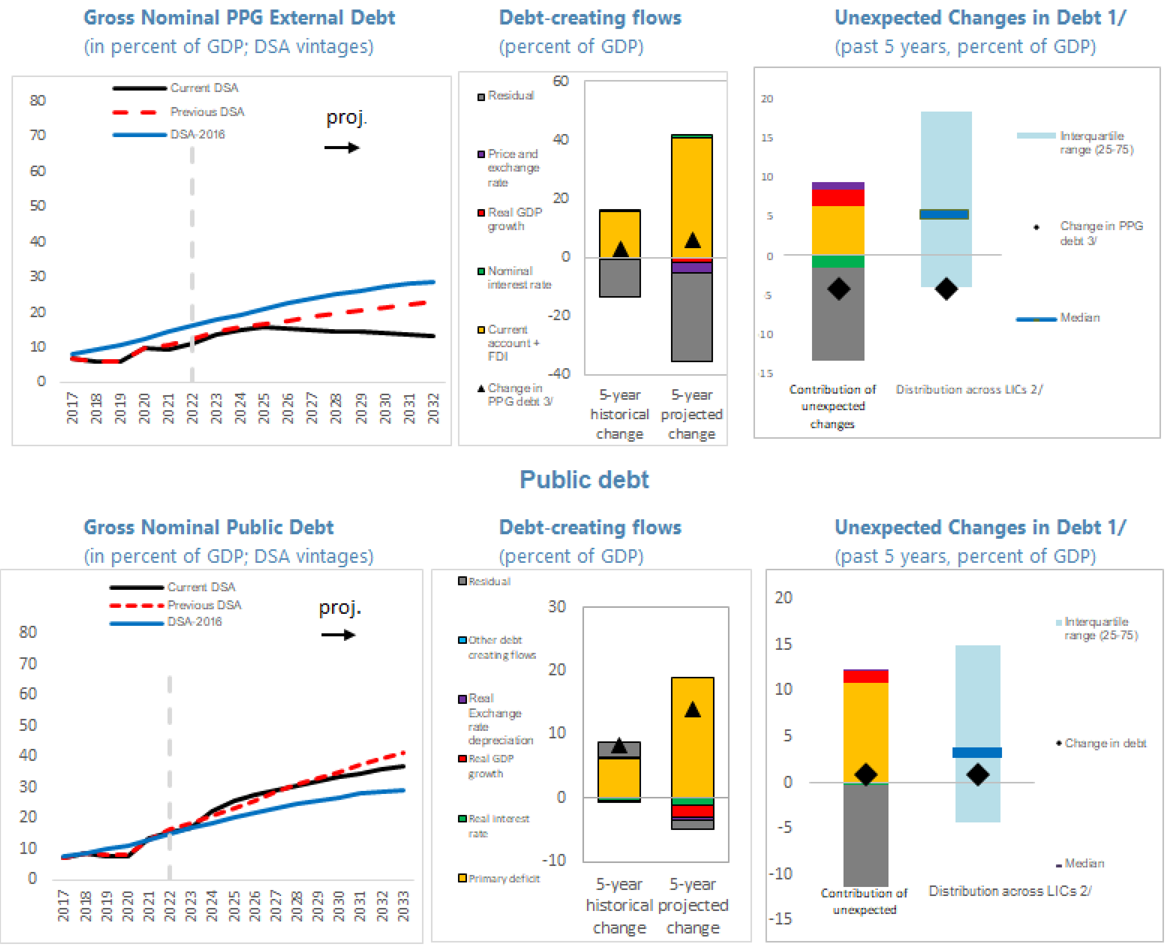
Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	34%	85%
Domestic medium and long-term	57%	10%
Domestic short-term	9%	5%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	1.3%	1.3%
Avg. maturity (incl. grace period)	35	35
Avg. grace period	8	8
Domestic MLT debt		
Avg. real interest rate on new borrowing	2.3%	2.3%
Avg. maturity (incl. grace period)	13	13
Avg. grace period	12	12
Domestic short-term debt		
Avg. real interest rate	6.2%	6.2%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2032. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 3. Solomon Islands: Drivers of Debt Dynamics – Baseline Scenario External and Public Debt



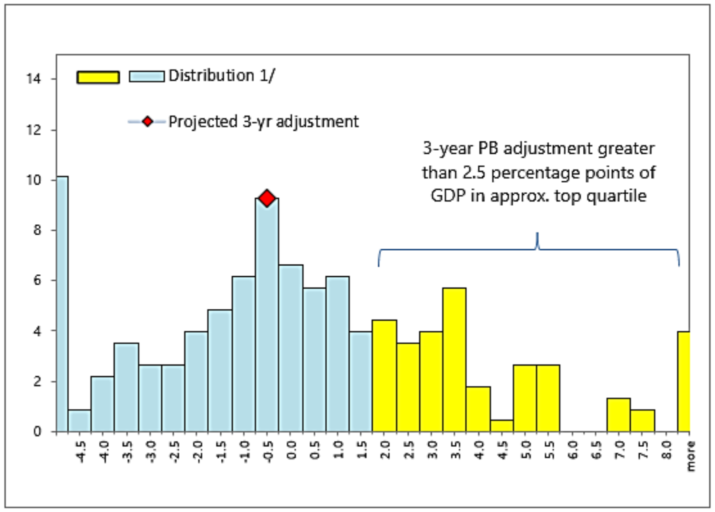
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

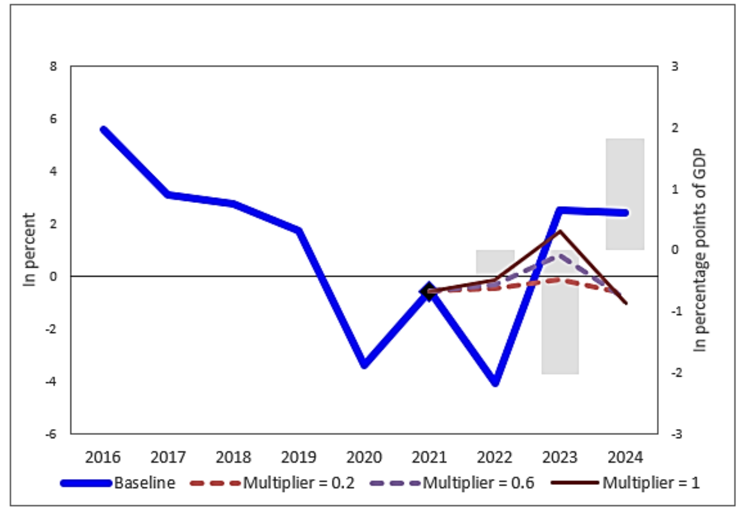
Figure. 4. Solomon Islands: Realism Tools

3-Year Adjustment in Primary Balance
(Percentage points of GDP)



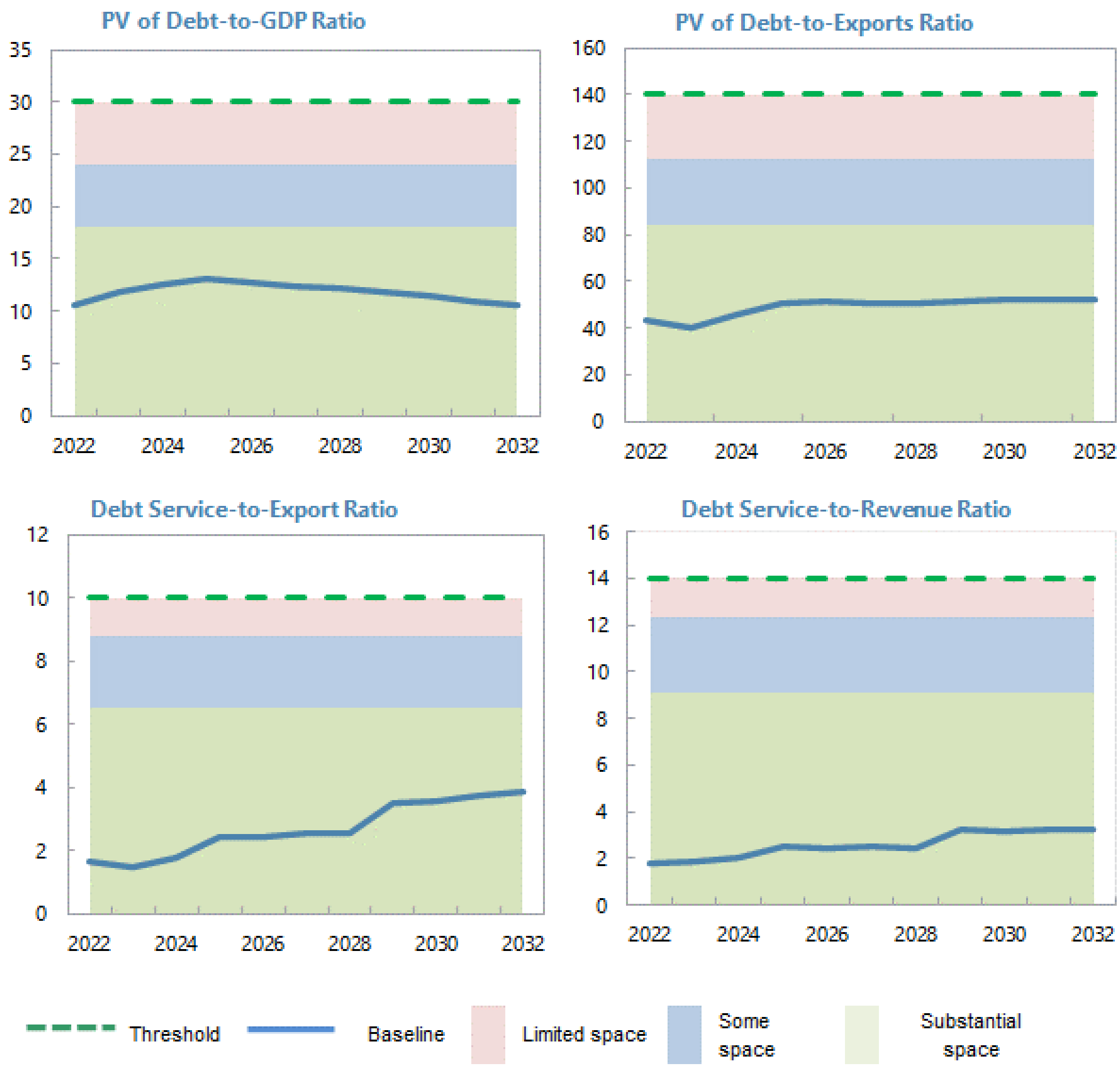
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) a growth paths under different fiscal multipliers (left-hand side scale).

Figure 5. Solomon Islands: Qualification of the Moderate Category, 2022-32 1/



Sources: Country authorities; and staff estimates and projections.

1/ For the PV debt/GDP and PV debt/exports thresholds, x is 20 percent and y is 40 percent. For debt service/Exports and debt service/revenue thresholds, x is 12 percent and y is 35 percent.

Figure 6. Solomon Islands: Alternative Fiscal and Financial Risk and Other Alternative Scenarios, 2022–32