# CENTRAL BANK OF SOLOMON ISLANDS

## MONETARY POLICY STATEMENT
## March 2020

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## 1 Overview

The continuation of the US-China trade war, geopolitical tensions and climatic events into the last half of the year saw a further downgrade in global economic growth for 2019 to only 2.9%. This was evident in the slow growth in both advanced economies and emerging markets.

Global commodity prices led by food, energy and beverages meanwhile firmed up in the last quarter after earlier periods of weaker performance. Nonetheless, global inflation eased during the year as weak demand and sluggish economic activity affected consumer prices in both emerging and advanced markets.

Meanwhile, economic activity in the Solomon Islands declined considerably in the last six months of 2019 due to the impacts of the US-China trade war and slow domestic activity. By sector, this was attributed to weak outturns from the productive commodities, manufacturing and services. Growth has therefore slowed to 1.2%, the slowest growth period since the Global Financial Crisis in 2009.

In line with subdued macroeconomic environment, the key monetary aggregates; reserve money, money supply and total liquidity all declined in the six months to December 2019. Private sector credit also grew slowly at only 2% with lending growth seen only in the personal, agriculture, distribution and forestry.

Additionally, external conditions deteriorated with a large current account deficit driven by falling exports and projected-related service payments. To finance this outturn, the capital and financial account posted a surplus associated with capital inflows. The gross foreign reserves also declined as a result. Moreover, the SBD continued to tumble against the USD, although it strengthened against the other key currencies.

After the build-up of cash reserves and a fiscal surplus position in the year to June 2019, government's fiscal results in the second half of the year turned around to a deficit position as programmes were implemented and expenditure pressures escalated. This came as revenue grew at a slower rate, particularly from taxes and donor grants.

Headline inflation picked up modestly in the last half of the year. This was driven by increases in food, alcohol, and restaurants with December 2019 recording a rate of 2.8%. Likewise, core inflation also increased to 2.6% at the end of the year.

With respect to the outlook for 2020, the Solomon Islands economy is only expected to moderately grow at 2.0%. This is a downward revision from earlier projections but takes into account the fall in logs and the possible impacts of the coronavirus. Nonetheless, growth will be supported by communication and construction as some key projects start this year.

Comparatively, the outlook for the medium term is more favourable at 3.9% as key infrastructure such as the SPG facilities and donor funded projects, and activities like gold ridge start operations.

Reflecting the near to medium term growth forecast, the outlook for the monetary sector is to trend with growth. Likewise, the external sector expects infrastructure project related imports in the current account deficit to be mostly financed by capital grants and loans. In contrast, fiscal sustainability and financing remains a concern over the next few years as tax revenues decline and expenditure pressures increase. Meanwhile, inflation is expected to ease at year-end 2020.

## 2 International Economic Developments

Global economic growth in 2019 was downgraded further to 2.9%, 10 basis points lower than the IMF's October WEO forecasts. This revised projection reflected prolonged trade policy uncertainty, geopolitical tensions, coupled with the impact of weather-related disasters in several economies. In 2020, global growth is projected to recover to 3.3%, underpinned by the easing of the United States (US)-China trade tensions following the signing of a partial US-China trade agreement in January 2020, backed by gradual improvements in domestic demand and investment in several emerging market economies. However, the recent Coronavirus outbreak is an emerging downside risk that is expected to weigh down on near term growth and has created a new uncertainty for the outlook[1].

Growth in advanced economies broadly slowed to 1.7% in 2019 as expected, mostly reflecting softer growth in the US during the December 2019 quarter. In 2020, growth in advanced economies is forecasted to ease to 1.6% underpinned by downward revisions across several major economies. In particular, the US economy is expected to return to a neutral fiscal stance amidst declining support from further loosening of financial conditions.

In emerging markets and developing economies, growth decelerated to 3.7% in 2019 although it is expected to rise to 4.4% in 2020 and 4.6% in 2021 on the back of projected recovery across major economies. Meanwhile, growth in China slowed to 6.1% in 2019 reflecting subdued industrial production following the protracted US-China trade war. In 2020, the Chinese economy is forecasted to moderate to 6.0% in 2020 and reach 5.8% in 2021 following the slowdown in labour productivity growth and continued external headwinds. Furthermore, the Coronavirus outbreak in late December 2019 is expected to lower near-term outlook for China.

Closer to the region, growth in Australia has increased at a slower pace in the December 2019 quarter to 2% year end. This outcome was driven by weak consumption growth amongst households coupled with subdued business confidence from the farm sector as a result of the effects of the drought and bushfires. In 2020, the economy is expected to strengthen to 2.75% and grow to 3% at the end of 2021 driven by the expected increase in consumption and housing market growth. As for New Zealand, growth slowed over 2019 to 1.6% at the end of 2019 from 2.3% in the September quarter, reflecting low business confidence and headwinds from global economic conditions. However, growth for New Zealand in 2020 is expected to recover and accelerate over the second half of the year to 2.5% and reach 3.1% end of 2020 on the back of monetary and fiscal stimulus and high export prices.

### 2.1 International Commodity Prices

The IMF's commodity price index rebounded by 5% to 120 index points in the December 2019 quarter after two consecutive quarters of weak performance. This outcome reflected the recovery seen across major commodities during the quarter with the beverages index increasing by 10% to 92 index points, food index grew by 18% to 104 index points, energy picked up by 7% to 132 index points while petroleum index picked up by 5% to 149 index points over the period. Similarly, tapis fuel price, the main imported fuel for the Solomon Islands continued to firm up to USD$73.92 per barrel at the end of December 2019 from USD $67.17 per barrel in the prior quarter.

### 2.2 Global Inflation

Global inflation and core inflation remained muted across both advanced and emerging market economies in 2019. This reflected subdued economic activity and weak demand which translated into lower metal and energy prices. Inflation in advanced economies was estimated at 1.4% in 2019 and is forecasted to rise to 1.7% in 2020 and 1.9% in 2021. On the other hand, inflation in emerging market and developing economies was estimated at 5.1% in 2019 and is projected to ease to 4.6% in 2020 and 4.5% in 2021.

On the regional front, inflation outcomes in Australia and New Zealand remained low and stable in 2019. Australia's headline inflation (seasonally adjusted) picked up by 30 basis points to 0.6% in the December quarter, reflecting the price rises in automotive fuel and fruits and vegetables. It is expected to increase slightly over the coming years as spare capacity in the Australian economy declines. In New Zealand, headline inflation rose 40 basis points to 1.9% at the end of 2019 following increased domestic capacity pressure and stronger wage growth. In 2020, headline inflation for New Zealand is projected to temporarily increase to 2.2% in the March quarter on the back of higher petrol and food prices coupled with the previous one-off price increases for non-tradable components.

## 3 Domestic Economic Developments

### 3.1 Monetary Conditions

In tandem with the slower domestic economic performance in the second half of 2019, monetary conditions evidently tightened. Reserve money(M0), broad money(M3), and total liquidity

[1] All statistics in this section are obtained from the International Monetary Fund (IMF) World Economic Outlook January 2020 update, unless otherwise stated.

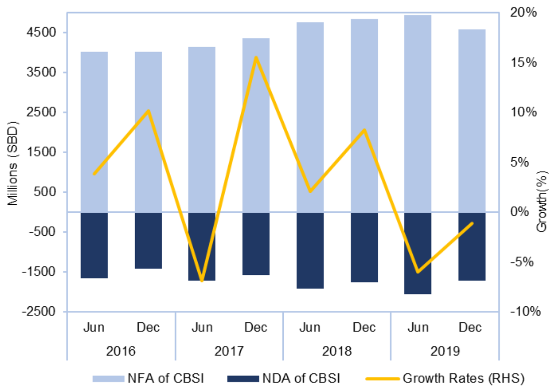
declined, although private sector credit (PSC) growth increased, albeit slowly. Interest rate margins narrowed at the end of the year.

### 3.1.1 Reserve Money

Reserve money declined by 1% to $2,853 million in the second half of 2019. The decline against June 2019 was reflected in the reduction in other depository corporations'(ODCs) call account balances by 5% to $1,934 million. On the other hand, currency in circulation increased by 8% to $911 million.

On the asset side, this result reflected the fall in the net foreign assets (NFA) by 7% to $4,581 million regardless of net domestic assets (NDA) had narrowed to minus 16% to $1,722 million. The fall in the NDA mirrored the reduction in the net domestic credit (NDC) and an increase in capital accounts.

**Figure 1: Drivers of Reserve Money**




Sourc:CBSI

### 3.1.2 Money Supply

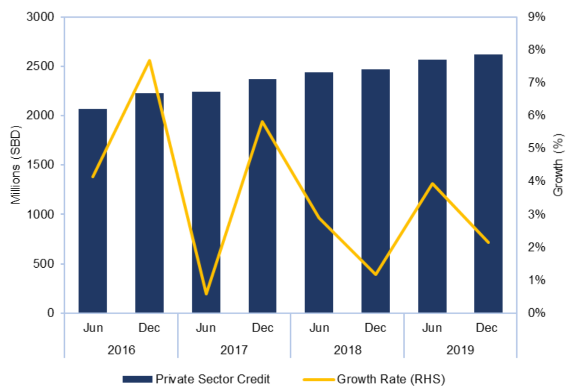
Broad money (M3) declined by 1% to $5,082 million against June 2019. The downturn was driven by a decrease in narrow money (M1) by 1% to $3,848 million despite an increase in other deposits by 1% to $1,234 million. Year on year, M3 declined by 3% to $5,082 million.

On the sources of M3 growth, the result was driven by a fall in the NFA of the depository corporations (DCs) by 3% to $4,781 million. On the other hand, NDA increased its net position from $27 million in June 2019 to $366 million. This was due to the rise in net domestic credit and reflects the drawdown of government deposits over the period.

### 3.1.3 Credit Conditions

Growth in Private Sector Credit (PSC) increased by 2% to $2,621 million in the second half of 2019, driven largely by an increase in ODCs' lending by 2% to $2,607 million. The key sectors supporting the growth were mainly, personal, agriculture, distribution and forestry. Nevertheless, credit issued to manufacturing, tourism, communication, and profession and other services decline during that time.

**Figure 2: Credit to Private Sector**

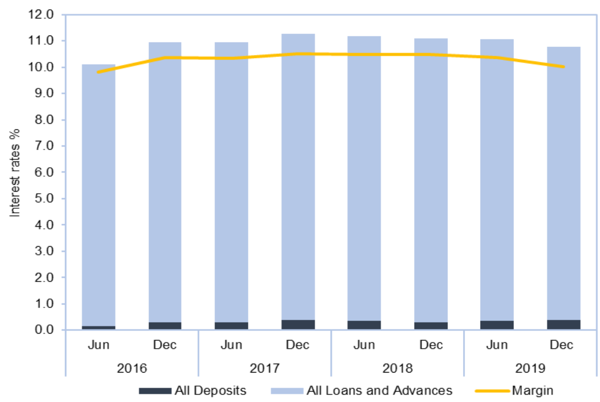



Source:CBSI

### 3.1.4 Interest Rate Trends

The ODCs' interest rate margin narrowed to 10.02% in the second half of 2019 from 10.37% in the prior six months. This mirrored the fall of the average weighted lending rates by 32 basis points to 10.40%. In addition, the weighted average deposit rates widened by 3 basis points to 0.38% in December 2019.

**Figure 3: Interest rate trends**

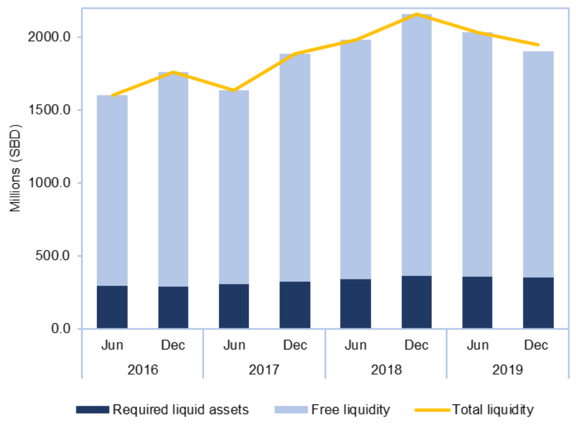



Source: CBSI

### 3.1.5 Liquidity Levels

Liquidity levels in the banking system dropped by 6% to $1,950 million during the last six months of 2019, following on from the 6% fall in the first half of the year. This downturn broadly reflects in the deterioration in CBSI's NFA and drawdowns of government deposits across the second half of the year. This saw free and excess liquidity to decline by 7% to $1,554 million and 8% to $1,370 million respectively.

**Figure 4: Liquidity levels**




Source: CBSI

The stock of Bokolo Bills floated by CBSI continued to remain capped at $750 million in the second half of 2019, with the interest rate declining by 2 basis points to 0.54%. Furthermore, the stock of treasury bills issued stood at $90 million in December with only limited borrowing space before reaching the new $100 million threshold. The interest rate remained unchanged for 91days, 182 days and 365 days at 0.49%, 1.12%, and 1.98% respectively.

## 3.2 Domestic Conditions

Domestic economic activities in 2019 and more so in the last six months, slowed drastically following subdued performance across the major sectors, particularly in commodity production, manufacturing, and services.

### 3.2.1 Economic Growth

The real GDP growth for 2019 is estimated at 1.2%, a significant fall from the estimated 3.9% growth in 2018. This was the lowest growth estimated for the past ten years driven by a combined impact of a weaker external and domestic conditions.

On the external side, the plunge in commodity prices severely affected export commodities particularly agricultural cash crops. Moreover, the China-US tariff-trade war further weakened demand for round logs exported to China, reducing export duty revenue for the government.

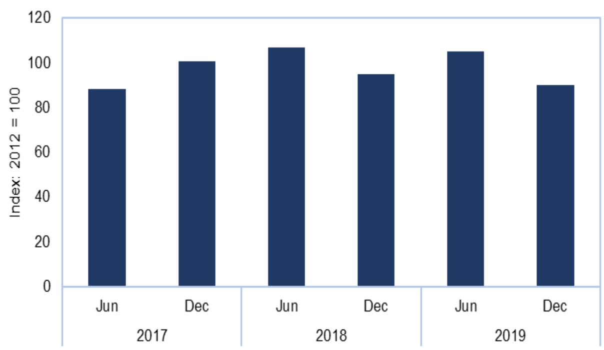
On the domestic environment, the delayed implementation of government programs due in part to the national election, the formation of a new government and associated policy changes contributed to disrupted business activity in some sectors of the economy. In addition, the decline in fiscal revenue inhibited potential stimulus responses by government.

In the September 2019 Monetary Policy Statement, CBSI forecasted 2019 growth at 2.7% based on indicators in the first half of 2019. However, the outturn of major sectors of the economy in the second half of 2019 tilted downwards considerably. The production index indicator for the second half of 2019 dropped below the level that was anticipated, the pick-up in manufacturing activities was lower than expected, and annual indicators for services which composed 57% of GDP showed a slower growth at the end of 2019.

### 3.2.2 Production Index

Domestic production activities weakened in the second half of 2019 with the production index declining by 5% to 90 points. On an annual basis, the production index fell by 7% to 98 points in 2019. This was driven by falls in round logs by 9%, copra by 59%, coconut oil by 15%, and palm oil by 1%. These more than offset the increased cocoa production and fish catch by 2% and 6% respectively.

**Figure 5: Half Yearly Production Index**

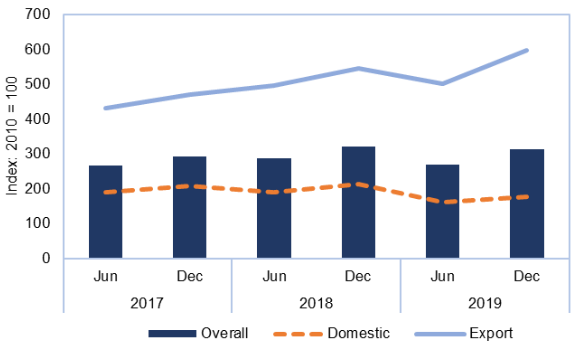



Source: CBSI

### 3.2.3 Manufacturing

Manufacturing activities strengthened in the second half of 2019 as the manufacturing index increased by 42 points to an index of 312. The pick-up in the second half of 2019 was not sufficient to offset the decline in the first half of 2019. As a result, the manufacturing index on annual terms declined by 4% to an index of 291 in 2019 due to the decline in manufactured goods for domestic consumption that offset the rise in manufactured goods for exports.

**Figure 6: Manufacturing Index Trend**




Source: CBSI

### 3.2.4 Other Sectors

Other sectors of the economy showed a mix performance in the second half of 2019. Starting from a higher growth level, the communication services remained buoyant as the communication index jumped 47% to 267 points resulted from higher internet usage and mobile calls. Moreover, total visitor's arrival increased 23% to 17,003 visitors due to higher number of visitors for holidays picked up in December including the Seventh Day Adventist Church Pathfinders' participants from other pacific island countries travelling to Honiara for their camporee.

On a moderate and smaller growth path, total lending to wholesale and retail increased by 4% to a total of $558 million and electricity generations picked up slightly by 1% to 49,892 Kilowatt-hour. On the downside, the construction indicator dropped 21% to 123 applicants. Similarly, new FDI approved applications fell by 10% to 56 applicants.

### 3.2.5 Employment

The labour market conditions remained stable in the second half of 2019. The SINPF members' contribution increased by 2% to a total of 60,643 (active and slow active) contributors. This is an additional 933 contributors for the second half of the year, a minor fall from an additional 974 contributors in the first six months of the year. However, job vacancies tallied from newspapers recorded a fall of 25% to 234 vacancies in the second half of 2019, indicating additional demand for employment slowed during the period.

## 3.3 External Conditions

The Balance of Payments (BOP) position posted a deficit of $370 million in the second half of the year from a revised $78 million surplus in June 2019. This came from a marked deterioration of the current account deficit amidst a relative raise in the capital and financial account surplus. Accordingly, the gross foreign reserves declined over the period.

On an annual basis the results in the second half of the year drove the outcome with a turnaround from a surplus of 5% of GDP in 2018 to a deficit of 3% of GDP in 2019. This mainly came from the worsening current account deficit and the subsequent fall in reserves.

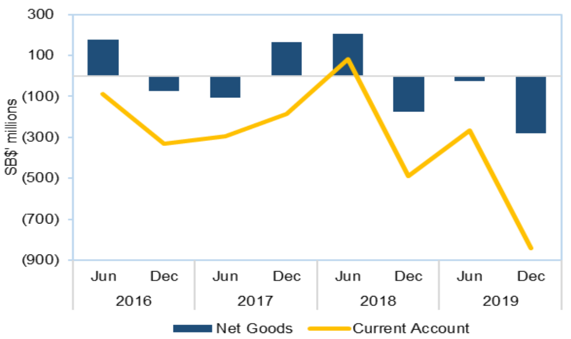
### 3.3.1 Current Accounts

The current account deteriorated to a deficit of $841 million from a revised $268 million deficit in the first six months of 2019. A significant weakening in the trade in goods and services deficit to $281 million and $623 million respectively, and a turnaround in the primary income to a deficit of $122 million from a $43 million surplus contributed to the outcome.

The trade in goods outturn was due to the drop in exports by 17% to $1,711 million, particularly from forestry, fishery and other export. Meanwhile, imports slid by 5% to $1,991 million on the back of declines in chemical, basic manufactures and machinery imports in the last six months of year.

Likewise, the services deficit deteriorated to $1,000 million from $34 million as service payments for the construction of the undersea cable was completed at the end of the period. Meanwhile, donor related secondary income increased to $184 million compared to $94 million in previous.

**Figure 7: Trade and Current Account Balances**




Source: CBSI

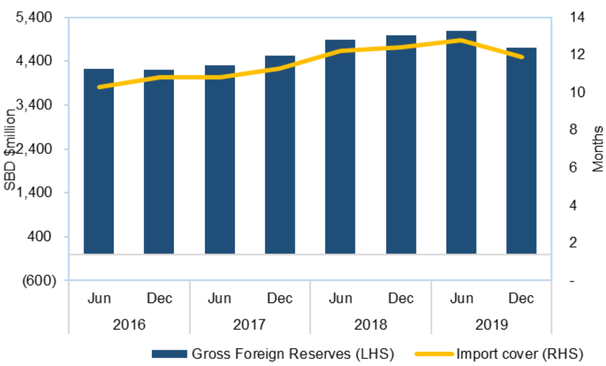
### 3.3.2 Capital and Financial Account

On the contra side, the 'capital and financial' account surplus went up by more than half to $461 million. This was due to increase in donor capital grants to $369 million, and net financial account increasing to $92 million from $40 million. The outcome in the capital account is associated with higher donor capital projects such as the undersea cable, while in the financial account due to the increase in foreign investment inflows.

### 3.3.3 Foreign Reserves

Due to the deterioration in the current account balance, the gross foreign reserves decreased by 7% to $4,706 million at end December 2019. This level of reserves is equivalent to around 11.9 months of import cover.

**Figure 8: Gross Foreign Reserves**

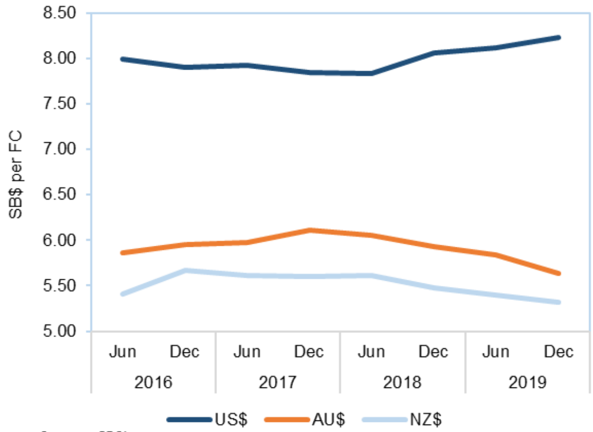



Source: CBSI

### 3.3.4 Exchange Rate

Global currency movements particularly the strengthening US dollar (USD) led to the Solomon Islands dollar (SBD) falling by 1.4% against the Trade Weighted Basket to 111.9 points. Against the key bilateral currencies, the SBD slid against the USD by 1.4% to $8.23 per USD. On the other hand, the SBD appreciated against the Australian dollar and New Zealand dollar by 3.7% to $5.63 per AUD and 1.5% to $5.32 per NZD respectively.

**Figure 9: Nominal Bilateral Exchange Rates**




Source: CBSI

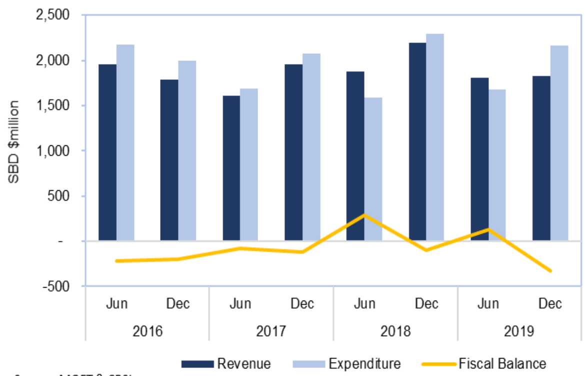
The country's Nominal Effective Exchange Rate remained at the same level. While, the Real Effective Exchange Rate on average appreciated by 0.9% during the period, reflecting the inflation differentials between the country and its trading partners.

## 3.4 Fiscal Conditions

Government's financial position deteriorated to a deficit of $331 million in second half of the year, from the $129 million surplus in the first six months of 2019 as budget pressures emerged in the second half of the year. This outcome mirrored the notable increase in total expenditure while total revenue collections weakened.

On an annual baisis, the fiscal poistion represented a deficit of 2% of GDP.

**Figure 10: Fiscal Balance**




Source: MOFT & CBSI

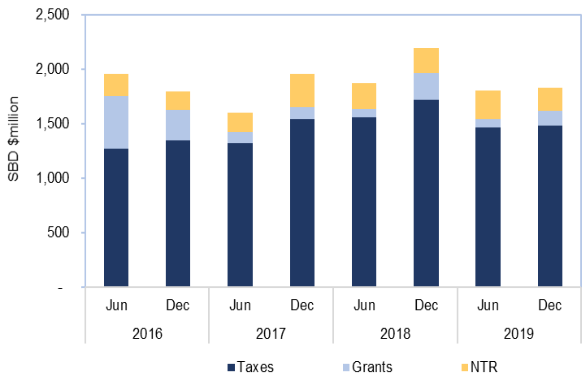
### 3.4.1 Revenue

Total revenue grew slightly by 1% $1,830 million in the second half of 2019, sustained by a slower growth in tax revenue together with higher grant receipts despite a fall in nontax revenue during the six months to December 2019. On a year-on-year basis, total revenue declined by 17%, and fell short by 12% against the budget.

Tax revenue increased by 1% to $1,480 million during the last six months of 2019. The marginal growth in tax receipts was supported by growths in income and profit tax, by 11% to $530 million, goods and services tax, by 18% to $356 million, and property tax, by 5% to $21 million. Conversely, tax on international trade and transactions contracted by 14% to $573 million underpinned by the fall in log export duties.

Grants received from donor partners grew notably to $136 million from to $78 million in the prior six months. Non-tax revenue, on the other hand, fell by 18% to $214 million driven by the decline in fishing license fee receipts during the last six months of 2019. Proportionally, tax revenue accounted for 81% of total revenue, non-tax, 12% and grant receipts 7%.

**Figure 11: Fiscal Revenue Collection**




Source: MOFT & CBSI

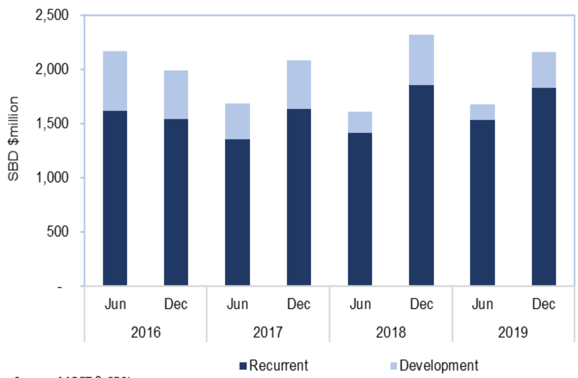
### 3.4.2 Expenditure

Total expenditure surged by 29% to $2,160 million in the six months to December 2019, driven by increases in both recurrent and development outlays. Increased spending in the latter half of the year is an expected cyclical pattern. However, this level of spending was lower than the same period in 2018 and the budget by 6% and 3% respectively.

Recurrent expenses, which accounted for 85% of total expenditure, grew by 20% to $1,831 million over the review period. Growths in payroll by 8% to $723 million, other charges by 16% to $884 million, and other expenses which surged to $124 million from $9 million underlined this outcome. Increases in subsidies and social benefits outlays also contributed to this increase in recurrent spending.

Development spending more than doubled to $330 million during the second half of 2019 attributing to increased spending on buildings and structures, and machinery and equipment. This level of spending represents 15% of total expenditure.

**Figure 12: Fiscal Expenditure**

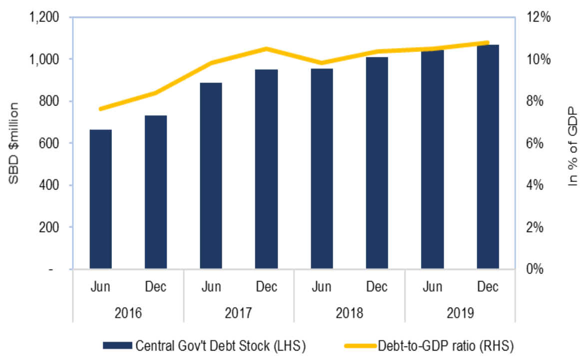



Source: MOFT & CBSI

### 3.4.3 Public Debt Stock

Total Central Government's outstanding debt stock grew by 3% to $1,070 million at the end of December 2019. The increase mirrored additional external loan disbursements, depreciation of the SBD against the USD and increases in domestic treasury bills issued. Consequently, the current debt-to-GDP ratio rose to 11% of GDP at the end of December 2019. By share, external debt constituted 74% of the total outstanding debt stock while domestic debt accounted for 26%. Meanwhile, total debt repayment increased slightly to $32 million from $31 million in the first six months of 2019.

**Figure 13: Public Debt Trends**




Source: MOFT & CBSI

## 3.5 Inflation Developments

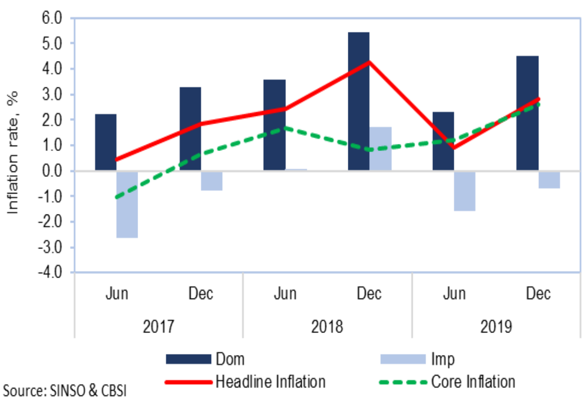
Inflationary pressures in the country picked up modestly in the second half of 2019 relative to a year ago. The national headline inflation for Solomon Islands rebounded to 2.8% in December from 0.9% in June, following the slow-down in inflationary pressures recorded in the first six months of 2019. The uptick in inflationary pressures reflected the price increases in both domestic and imported inflation over the period. Compared to a year ago, headline inflation was 1.4 percent lower.

Domestic inflation, the key driver of consumer prices during period surged from 2.3% to 4.5%. The outcome reflected the price rises of food, alcohol, housing utilities, clothing and 'hotels and restaurants'. Moreover, supply driven price increases such as in local food could be addressed through investments in the food production and manufacturing, as well as in robust price control measures.

Meanwhile, imported inflation picked up from minus 1.6% in June to minus 0.7% in December. Contributing to the rise in imported prices were increases across food, recreation and furnishings. This outweighed the price declines in fuel related transport, housing utilities and miscellaneous goods during the period.

Core inflation rose to 2.6% in December from 1.2% in June reflecting the price increases in non-food and non-energy items during the period.

**Figure 14: Inflation Developments**




Source: SINSO & CBSI

## 4 Domestic Economic Outlook

### 4.1 Real Economy

The economic growth for 2019 is projected to slow further to 1.2%, a downward revision of 1.4 percentage points from the September MPS projections. This downward revision reflected broad-based subdued performances across major sectors notably the production, manufacturing and the services sectors.

On-going weak external demand conditions coupled with deteriorating commodity prices and escalating trade barriers in the global environment in turn put a drag on demand mostly for round logs which accordingly weighed markedly on growth.

Against these external and domestic economic backdrops, growth in 2020 is projected to pick up modestly to 2.0%. This will be supported predominantly from the secondary and services sectors particularly, the construction and communication. Moreover, the outlook for this year considers the tapered growth and disruption that is likely to be caused by the impact of the Coronavirus outbreak on the business activities in the country, as well as in the global economy.

As such, the primary sector, specifically the forestry and the agricultural sectors are expected to fall in 2020, outweighing the benign gains in the non-primary sectors.

Over the medium term, the growth forecast is expected to be favourable and grow at an average growth rate of 3.9 % in line with major planned projects in the pipeline including the anticipated construction of the South Pacific Games facilities, the Tina Hydro project, other donor funded projects and the resumption of Gold Ridge Mining over the course of the medium term. However, delays in these planned projects, a faster decline than expected in round logs, heightened fiscal pressures and a slower pick up in commodity prices could derail this growth over the medium term.

### 4.2 Fiscal

In terms of the fiscal outlook for 2020, the anticipated weak revenue growth prospects for logging and related activities could undermine the government revenue over the medium term. Thus, growth in revenue is expected to be sustained by the grants and the non-tax components.

Furthermore, heightened pressures to maintain social services, large number of overseas scholarships and build big ticket projects in the pipeline amid anticipated slowing revenue suggests a further deterioration of the fiscal balance over the medium term.

### 4.3 External

The forecast for the balance of payments is for a widening of the current account deficit on account of weaker exports and higher capital imports associated with the construction for the planned major projects. Although, this is anticipated to be partially financed by the surplus capital and financial accounts, this is not sufficient to offset the anticipated deficit over the medium term. As a result, the balance of payments projects a wider current account deficit position over the next three years and a resultant slightly weaker gross foreign reserves going forward.

### 4.4 Monetary

In line with anticipated improved economic conditions over the medium term, reserve money and broad money are expected to grow modestly. Private sector credit is projected to also increase but at a lower rate. As a result, excess liquidity is anticipated to grow accordingly.

### 4.5 Inflation

The higher price pressures from food, alcohol and betel nut during the festive season are expected to persist into first quarter of 2020 and are projected at around 3.1% by June 2020.

In the last six months of the year, inflation is projected to ease in September as alcohol and food prices stabilize and offset expected rises in fuel. It is projected to reach around 2% at the end of the year. The projected annual average inflation for 2020 is around 2.7%.

Nonetheless, there are risks to this inflation outlook. An upside risk for lower inflation is weak consumer spending due to a larger than anticipated impact of the coronavirus that could inhibit global and domestic demand. Meanwhile, a downside risk that could affect supply conditions and trigger higher inflation include persistent bad weather in the fourth quarter that could affect food prices, and any geopolitical shocks that could affect fuel prices.

## 5 Monetary Policy Stance

Given the weak economic conditions in the second half of 2019, and the prospect for relatively moderate growth in 2020, CBSI has adopted an expansionary monetary policy stance for the next six months. Moreover, since headline inflation remains within acceptable margins, this stance aims to further enhance growth in the economy.

CBSI will closely monitor the financial system and macroeconomic developments should there be any other macroeconomic shocks, particularly related to the current global pandemic. It may consider taking appropriate action if necessary.