INTERNATIONAL MONETARY FUND

IMF Country Report No. 25/49

SOLOMON ISLANDS

February 2025

2024 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR SOLOMON ISLANDS

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 2024 Article IV consultation with the Solomon Islands, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its February 19, 2025 consideration of the staff report that concluded the Article IV consultation with the Solomon Islands.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 19, 2025, following discussions that ended on November 22, 2024, with the officials of the Solomon Islands on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 27, 2025.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Statement by the Executive Director** for the Solomon Islands.

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.

IMF Executive Board Concludes 2024 Article IV Consultation with Solomon Islands

FOR IMMEDIATE RELEASE

Washington, DC – **February 25, 2025:** On February 19, 2025, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Solomon Islands.

Solomon Islands has weathered important shocks including civil unrest and the pandemic, successfully hosted the Pacific Games, and conducted peaceful general elections. These achievements have raised the country's profile and strengthened national unity, but with costs—public debt has nearly tripled since before the pandemic, and the government's cash reserves have been significantly depleted.

Modest growth is expected at 2.8 percent in 2025, slightly above the 2.4 percent growth estimated for 2024, while inflation, estimated to have returned to 3.4 percent at end-2024, is envisaged to reach 3.9 percent at end-2025. The fiscal deficit is expected to widen slightly from 3.1 percent of GDP in 2024 to 3.3 percent of GDP in 2025, underpinned by continued spending pressures and externally financed infrastructure projects. The current account deficit is estimated to have narrowed to 4.2 percent of GDP in 2024, but projected to widen to 7.7 percent of GDP in 2025 as economic activity gains momentum. Foreign exchange reserves remain adequate, covering 9 months of imports.

Risks to the outlook are tilted to the downside. They include under execution of the budget, extreme climate events, political instability, and commodity price volatility. Declining logging activity and the undiversified economic base, compounded by weak governance, constrain growth potential. Both the current account and fiscal deficits are expected to persist over the medium term.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They concurred that while the Solomon Islands' economy has weathered multiple shocks well and recently benefited from successfully hosting the Pacific Games and peaceful general elections, public debt is increasing, medium-term growth prospects appear moderate, and per capita income growth remains stagnant. Against this backdrop, Directors emphasized the importance of rebuilding

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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] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

cash buffers and ensuring fiscal sustainability, while boosting growth prospects through economic diversification and governance reforms.

Directors stressed the need to improve the effectiveness of fiscal policy by addressing weaknesses in fiscal data and public financial management, including by ending the practice of unfunded spending. They also called for tightening the 2025 Budget to start a gradual recovery of cash balances. Directors underscored the importance of creating fiscal space to accelerate investment in development priorities. To this end, they recommended advancing domestic revenue mobilization, such as introducing a value added tax. Enhancing the quality, transparency, and accountability of public expenditure, including by undertaking the Public Expenditure and Financial Accountability assessment, would also be important. Directors saw merit in introducing a simple, ex-ante guideline for annual budget formulation as an interim step toward a fiscal rule.

Directors agreed that the current monetary policy stance and exchange rate regime are appropriate. They stressed the importance of preserving the central bank's autonomy, including by limiting purchases of government bonds and implementing the remaining Safeguards Assessment recommendations. Directors also underscored the need to keep the exchange rate fully aligned with the value of the updated currency basket and to enhance transparency and communication with market participants. While the financial sector remains stable, Directors encouraged further reforms to strengthen regulatory and supervisory frameworks and boost financial intermediation and inclusion. They stressed the need to strengthen the AML/CFT framework, including due to the planned introduction of the Citizenship by Investment program.

Directors encouraged the acceleration of structural reforms to support economic diversification and private sector development, with capacity development support from the IMF and other development partners. They agreed that addressing governance weaknesses remains a priority, including by improving the capacity and independence of the anti-corruption institution.

Table 1. Solomon Islands: Selected Economic Indicators, 2019–2029

Per capita GDP (2023): US$2200

Population (2023): 768,690

Quota: SDR 20.8 million

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Est.			Proj.			
GROWTH AND PRICES	(In percent change, unless otherwise indicated)										
Real GDP	1.7	-3.4	2.6	2.4	2.7	2.5	2.8	2.9	2.9	3.0	3.0
CPI (period average)	2.2	2.9	0.2	5.4	5.1	3.7	3.8	3.7	3.4	3.3	3.3
CPI (end of period)	2.6	-2.6	4.6	8.7	4.3	3.4	3.9	3.5	3.3	3.3	3.3
GDP deflator	1.2	-1.3	-5.5	2.0	3.9	1.3	1.3	1.3	1.4	1.4	1.4
Nominal GDP (in SI$ millions)	13,234	12,617	12,228	12,775	13,911	14,685	15,492	16,370	17,311	18,235	19,217
Nominal GDP (in US$ millions)	1,619	1,536	1,523	1,566	1,661	1,753	1,850	1,954	2,067	2,177	2,294
CENTRAL GOVERNMENT OPERATIONS	(In percent of GDP)										
Total revenue and grants	34.1	37.9	35.9	38.3	36.3	32.7	32.5	32.6	32.7	32.8	32.8
Revenue	25.8	24.6	24.8	23.1	22.9	23.2	23.0	23.1	23.2	23.3	23.3
Grants	8.2	13.4	11.1	15.2	13.4	9.5	9.5	9.5	9.5	9.5	9.5
Total expenditure	35.6	40.4	37.8	40.8	40.1	35.8	35.7	35.8	35.8	35.8	35.9
Expense	29.0	31.9	28.3	31.4	29.8	27.9	27.2	27.3	27.4	27.4	27.5
Net acquisition of nonfinancial assets	6.6	8.5	9.5	9.3	10.3	7.9	8.5	8.5	8.4	8.4	8.4
Net lending (+) / Net borrowing (-)	-1.5	-2.4	-1.9	-2.5	-3.8	-3.1	-3.3	-3.2	-3.1	-3.1	-3.1
External	0.0	-1.4	-1.1	-0.1	-2.9	-2.3	-1.8	-1.9	-1.9	-1.8	-1.8
Domestic	-1.5	-1.0	-0.7	-2.4	-0.9	-0.8	-1.5	-1.3	-1.2	-1.2	-1.3
Central government debt 1/	7.8	12.8	15.9	15.5	20.3	22.3	24.4	26.2	27.9	29.5	31.0
Public domestic debt	1.7	2.8	6.1	5.9	8.6	8.9	9.8	10.6	11.1	11.7	12.4
Public external debt	6.1	10.0	9.8	9.6	11.7	13.4	14.5	15.6	16.7	17.7	18.6
MACROFINANCIAL	(In percent change)										
Credit to private sector	6.2	0.3	-0.4	0.8	4.7	3.0	3.0	3.0	3.0	3.0	3.0
Broad money	-3.1	6.6	1.9	5.3	6.1	6.8	5.5	5.7	5.8	5.3	5.4
Reserve money	-7.1	23.0	10.6	4.0	9.9	6.0	5.5	5.7	5.8	5.3	5.4
BALANCE OF PAYMENTS	(In percent of GDP, unless otherwise indicated)										
Current account balance	-9.5	-1.6	-5.1	-13.7	-10.4	-4.2	-7.7	-7.5	-7.4	-7.5	-7.4
Trade balance (goods and services)	-10.0	-8.5	-13.4	-22.3	-19.8	-11.6	-15.3	-15.3	-15.6	-16.1	-16.5
Exports	36.4	28.5	26.9	25.8	32.6	34.6	33.2	32.8	32.1	31.4	30.7
Imports	46.4	37.0	40.4	48.1	52.3	46.2	48.6	48.1	47.7	47.5	47.2
Gross Remittances	1.1	1.5	2.1	3.3	3.7	3.5	3.6	3.8	3.9	4.1	4.3
Capital and Financial Account	7.3	3.0	6.7	13.2	13.6	4.0	6.9	7.3	7.5	7.5	7.5
Foreign direct investment (+ = decrease)	-1.8	-0.4	-1.5	-2.6	-4.3	-0.9	-2.3	-2.6	-2.7	-2.8	-2.9
Overall balance (+ = increase)	-2.1	4.8	2.5	-2.0	3.3	-0.2	-0.8	-0.2	0.1	0.0	0.1
Gross official reserves (in US$ millions, end of period) 2/	574.1	660.6	694.5	655.2	682.0	679.1	664.3	661.0	662.8	663.2	664.6
(in months of next year's imports of GNFS)	12.1	12.9	11.1	9.0	10.1	9.1	8.5	8.0	7.7	7.4	7.0
EXCHANGE RATE (SI$/US$, end of period)	8.2	8.0	8.1	8.3	8.5	…	…	…	…	…	…
Real effective exchange rate (end of period, 2010 = 100)	127.5	129.9	124.8	132.3	136.0	…	…	…	…	…	…

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

1/ Includes disbursements under the Rapid Credit Facility (RCF).

2/ Includes SDR allocations made by the IMF to Solomon Islands in 2009 and in 2021.

INTERNATIONAL MONETARY FUND

SOLOMON ISLANDS

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

January 27, 2025

KEY ISSUES

Context. Solomon Islands has weathered the shocks of civil unrest, pandemic, and commodity price hikes, and achieved the milestones of hosting the Pacific Games in late 2023 and conducting peaceful general elections in April 2024. These achievements have raised the country's profile and strengthened national unity, but with costs—public debt has nearly tripled since before the pandemic, and the government's cash reserves have been significantly depleted. While staff expects continued modest growth in 2024 and 2025, medium-term growth prospects appear moderate and fiscal and current account deficits are expected to persist. Now is the time for the authorities to advance reforms to tackle the perennial challenge of stagnant per-capita income growth, while ensuring fiscal sustainability and resilience.

Main policy recommendations.

- **Fiscal policy**. There is an urgent need to enhance the effectiveness of fiscal policy by addressing fundamental weaknesses in fiscal data and public financial management: a financing gap in the budget proposal should be eliminated, among others. Staff proposes to set a ceiling on the domestically financed primary budget deficit, which indicates that the 2025 budget should be tightened to start recovering cash buffers gradually. Domestic revenue mobilization is essential to accelerate investment in development priorities. Improving the transparency and accountability of public spending remains a priority, including through implementing the lessons learned from the pandemic stimulus package.
- **Monetary and exchange rate policies**. The monetary policy stance is appropriate and should remain data dependent. Further purchases of government bonds should be avoided given the current economic conditions. The current exchange rate regime remains appropriate, and the exchange rate should fully reflect movements in the updated currency basket.
- **Financial sector policies.** While the financial sector remains stable, reforms to further promote digital financial services are needed to enhance financial inclusion, especially among women and in rural areas. Strengthening legal and supervisory frameworks for AML/CFT should be expedited. Staff urges careful consideration in the introduction of the Citizenship by Investment program, in light of the limited AML/CFT capacity.
- **Structural reforms**. There is scope for significant productivity gains in the agriculture and fisheries sectors through targeted mechanization and improved connectivity in rural areas. Concrete measures are needed to strengthen the capacity of anti-corruption institutions and address governance weaknesses in the forestry and mining sectors.

Approved By
Nada Choueiri (APD) and Jacques Miniane (SPR)

Discussions took place in Honiara during November 11–22, 2024. The staff team comprised M. Yabara (head), Y. Ojima, K. Ranadi, N. Suryakumar (all APD), and Y. Rattakul (STA). T. Doss (OED) joined the mission. C. Reis, R. Paewai, and P. Mahmud (all APD) provided excellent editorial and research assistance. R. Merga (RES), I. Yakadina (APD), and S. Cagilaba, previous team members, contributed to the report. The mission met with the Minister of Finance and Treasury M. Sogavare, Governor of the Central Bank of Solomon Islands L. Forau, other government officials, private sector representatives, civil society organizations, and development partners.

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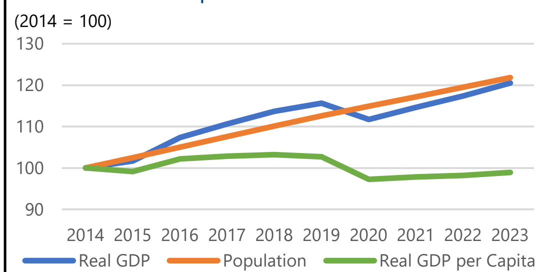
CONTEXT

1. **Solomon Islands is a small, low-income, and fragile state with stagnating per capita income growth**. The country consists of nearly a thousand islands, with three quarters of its 0.8 million population living in rural areas and largely relying on subsistence agriculture and fisheries. The country continues to face development challenges stemming from geographical dispersion, vulnerability to natural disasters and climate change[1], tenuous national unity, and weak state institutions, as identified in the Country Engagement Strategy (see Annex III in the 2023 Solomon Islands Article IV Staff Report). Output growth has averaged 2.0 percent over the past decade, lagging behind the average annual population growth. As a result, real GDP per capita is lower than it was a decade ago.

Real GDP and Population: 2014-2023



Source: Solomon Islands National Statistics Office and IMF staff estimates.

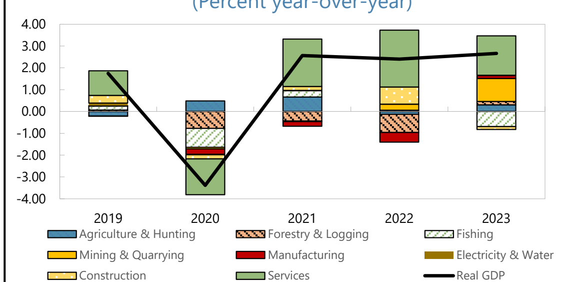
2. **The country has navigated a series of shocks and completed two landmark events.** The economy faced civil unrest in Honiara in late 2021, the pandemic in early 2022, and commodity price hikes following Russia's war in Ukraine. Additionally, the country hosted the Pacific Games in late 2023 and conducted peaceful general elections in April 2024. These achievements have elevated the country's profile and firmed up national unity, but with costs and risks—public debt has nearly tripled since before the pandemic, and the government's cash reserves have been significantly depleted. The new government, which took office in May 2024, has prioritized economic recovery, good governance, national unity, and human capital development. The authorities face the challenge of tackling these priorities, while restoring fiscal sustainability.

RECENT DEVELOPMENTS

3. **The economy has continued to grow, albeit at a slower pace.** Output is estimated to have grown by 2.5 percent in 2024, down from an estimated 2.7 percent in 2023, as the stimulus from the Pacific Games (see Box 1) faded and economic activity slowed around the general elections.[2] Stronger-than-expected performance

GDP Contribution by Sector

(Percent year-over-year)



Source: NSO, IMF Staff Estimates

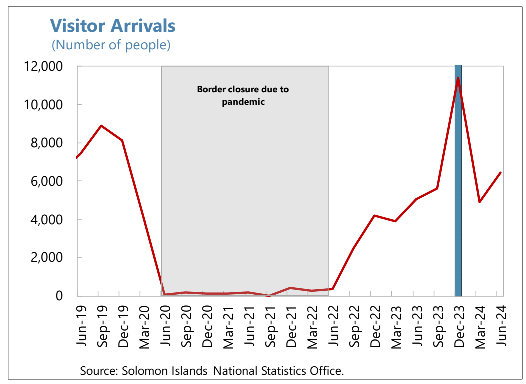
[1] The country has a high exposure to cyclones, heavy rainfalls, earthquakes, and tsunamis, accompanied by limited capacity to cope with them.

[2] The Solomon Islands National Statistics Office (SINSO) released its GDP estimates for 2021 and 2022 in February 2024. These estimates indicate significantly better performance than the preliminary estimates by the authorities and the IMF, reflecting the resilience of the informal sector during the pandemic. Staff's estimates incorporate these figures, although the SINSO has indicated that revisions may occur when it releases the 2023 estimates.

in the forestry, manufacturing, and construction sectors has been driving growth, supported by favorable weather conditions, global demand, and donor-funded infrastructure projects.

Box 1. Hosting the 2023 Pacific Games: Benefits and Costs[1]

During November 11-December 2, 2023, Solomon Islands hosted the Pacific Games, a multi-sport event held every four years in the Pacific, for the first time. 5,000 athletes and officials from 24 countries and territories in Oceania gathered to compete in 24 sports events. It was a monumental and expensive event, requiring years of preparation, the mobilization of the full potential of all Solomon Islanders, and a large amount of money. COVID-19 further complicated the preparations. The government originally estimated the multi-year budget for hosting the Pacific Games, including the construction of facilities, at SI$2.5 billion, nearly one-fifth of GDP in 2019.



The Pacific Games provided a valuable opportunity to build much-needed infrastructure with generous support from donors. Key projects funded by donors included a new regional airport, several major roads, a new wharf, sports facilities, including a new stadium, and other critical infrastructure upgrades. Increased construction activity in the run-up to the Games supported the country's recovery, while significantly widening the current account deficit.

Hosting the Pacific Games has helped to rally national unity and enhance recognition of Solomon Islands. More than 11,000 visitors came to Solomon Islands in the fourth quarter of 2023, double the number in the previous quarter, laying the foundation for development of the nascent tourism industry.

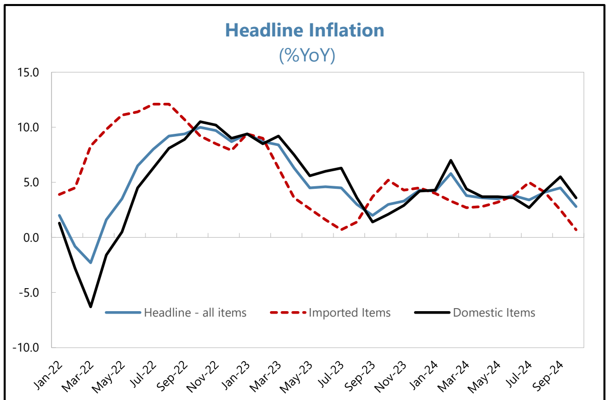
The Pacific Games also brought challenges. Faced with a cash crunch in the run-up to the Games, the government imposed strict controls on spending not related to the Games or the Constituency Development Funds (CDFs)[2], crowding out other priority spending. The spending controls exacerbated delays in government payments to suppliers and vendors, posing a risk to financial stability (CBSI, Financial Stability Report 2H23). The government issued a significant amount of domestic bonds: the amount of public debt increased by 60 percent (2.7 percent of GDP) in 2023. Facilities built for the Games require significant maintenance costs down the road.

Continued efforts by stakeholders are needed to leverage the legacy of the Games for future growth. First, the government should complete and report on an audit of Pacific Games-related funds. Facilities built for the Games should be handed over to appropriate agencies, along with sound plans for their effective use. The government should establish a system to ensure that the maintenance and management costs of these facilities are continuously funded as necessary.

[1] Prepared by Irina Yakadina (APD).

[2] The CDFs are allocated to each of the 50 Parliament Members to be spent in their constituencies.

4. Inflation is on a downward trend. Headline inflation slowed down from the recent peak of 10.0 percent year-on-year (y-o-y) in October 2022 to 2.8 percent in October 2024. Both imported and domestic inflation declined as food and fuel prices stabilized globally and domestically, with year-end inflation expected to have settled around 3.4 percent. Based on the expectation of continued easing of inflation, the Central Bank of Solomon Islands (CBSI) slightly eased its monetary policy in September 2024, by reducing the Cash Reserve Requirement from 6 percent to 5.5 percent.



Source: CBSI

5. The current account balance is estimated to have improved in 2024, supported by robust export performance and lower imports. The current account deficit is estimated to have narrowed significantly from 10.4 percent in 2023 to 4.2 percent in 2024. This is owing to favorable fish and mineral exports[3] and a decline in imports, especially machinery, reflecting the slowdown in economic and government activity after the Pacific Games and around the general elections. Robust remittances, underpinned by increasing seasonal workers under labor mobility schemes, are expected to contribute to the lower current account deficit. Foreign exchange reserves are expected to remain adequate, covering 9 months of imports. The External Sector Assessment (ESA) indicates that Solomon Islands' external position in 2023 was weaker than the level implied by fundamentals and desirable policies (Annex II).

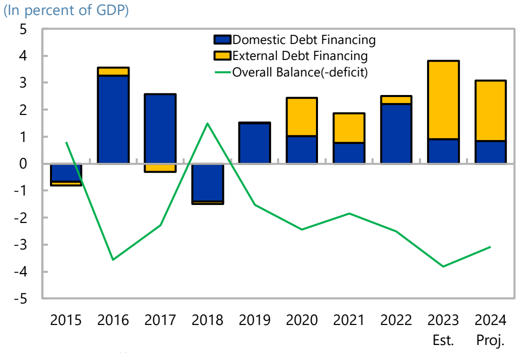
6. Fiscal deterioration due to the Pacific Games was less than previously expected, at the expense of other essential spending. Staff estimates a fiscal deficit of 3.8 percent of GDP in 2023, lower than projected at the time of the last Article IV Consultation, reflecting expenditure controls that crowded out spending other than for the Games and the CDFs, as well as additional donor support ahead of the Games (see Box 1).[4] Nevertheless, the government issued a substantial amount of bonds and treasury bills, increasing the amount of gross domestic debt by 60 percent in 2023 (2.7 percent of GDP). The central bank purchased government bonds in the secondary market in late 2023 and early 2024 to improve its income position, which staff believes consequently helped the market absorb newly issued government bonds. The government's broader cash balance remained at a low level of SI$200 million, or 0.4 months of total spending in 2023.

[3] Nickel exports commenced in the fourth quarter of 2023, in addition to gold exports that restarted in late 2022.

[4] The fiscal data have been substantially revised since the last staff report, including historical data. The CBSI has extended the coverage of the government finance statistics (GFS) grants revenue to include some off-budget donor grants, thereby enhancing consistency between the fiscal and BOP statistics. Expenditures have also been revised to account for spending funded by these off-budget donor grants. As a result, there are no significant changes in the fiscal balance up to 2020.

7. **Government financing is estimated to have remained tight in 2024, forcing the reintroduction of spending cuts.** Expenditure continued to exceed revenue in the first half of 2024, reflecting pressure on recurrent spending, including for the general elections, and the withdrawal of donor support. In response, the government introduced measures to save a total of SI$250 million (1.7 percent of GDP) through spending cuts across ministries and agencies. Meanwhile, the government passed a SI$113 million supplementary budget (0.8 percent of GDP), mainly to seek approval for expenditures financed by additional donor support, as well as to address urgent drug shortages. As a result, staff estimates the budget deficit at 3.1 percent of GDP in 2024.

Fiscal Balance and Financing
(In percent of GDP)



Source: IMF staff calculations.

OUTLOOK AND RISKS

8. **Staff expects a modest recovery in 2025, underpinned by stable inflation.** The economy is projected to grow by 2.8 percent in 2025, driven by the fishing, mining, manufacturing, and construction sectors. Inflation is expected to go up to an average of 3.8 percent in 2025, reflecting anticipated price increases such as for alcohol and beverages, but remain stable at an average of 3.3 percent in the medium term. The medium-term growth outlook appears moderate, at around 3 percent: mining, fishing, tourism, and manufacturing are expected to drive growth, while externally financed infrastructure projects would also support growth. On the other hand, declining logging activity due to dwindling reserves and the undiversified economic base with weak governance constrain the growth potential.

9. **Persistent current account deficits are expected over the medium term.** Staff expects that the current account deficit will widen to 7.7 percent of GDP in 2025 as economic activity, including externally financed infrastructure projects, comes fully on stream. The deficit is projected to remain elevated in the medium term, due to weak log exports and import needs for infrastructure projects. Increased remittances from the growing number of seasonal workers and mineral exports would partly offset the deficit. Foreign exchange reserves are forecast to keep declining, but remain within the adequacy range of three to eight months of imports, supported by continued aid inflows.

10. **Staff anticipates a further increase in the budget deficit in 2025, with low cash reserves.** In the 2025 Budget Strategy, the government expressed its commitment to safeguarding fiscal sustainability by reducing the budget deficit and rebuilding cash reserves, while accelerating investments to achieve resilient and sustainable growth. However, this commitment lacks concrete measures: the 2025 budget proposed by the government shows a larger deficit than the original 2024 budget, in addition to a sizable financing gap, raising concerns that the budget will again be under-implemented. Staff expects the fiscal deficit to result in 3.3 percent of GDP in 2025, larger than in 2024, assuming the reintroduction of expenditure controls and additional donor support.

The strategy has no concrete plan to rebuild cash reserves.

11. Fiscal deficits are expected to persist over the medium term, raising concerns about the sustainability of domestic financing. The drivers of the deficits include expenditure needs to advance government priorities, maintenance costs for infrastructure, and continued weak revenue trends due to declining log exports. The public debt-to-GDP ratio is projected to continue rising, reaching the authorities' 35 percent threshold in the early 2030s. The Debt Sustainability Analysis (DSA) indicates that the overall risk of debt distress remains moderate, while the risk of external debt distress has improved from moderate in the previous DSA to low, reflecting better-than-expected export performance. Solomon Islands faces significant challenges and risks stemming from the government's low cash balance, an undiversified economic base, and vulnerability to natural disasters and climate change. It is expected that the country will rely increasingly on higher-cost and shorter-term domestic financing. This would not only significantly increase debt service costs, but also expose the government to various risks, including refinancing risks and crowding out of private investment, due to the low absorptive capacity of the economy and market.

12. Risks to the outlook are tilted to the downside (Annex I). Continued fiscal challenges—under execution of the budget due to a shortage of funding—could adversely affect the economy. Solomon Islands remains particularly vulnerable to extreme climate events and commodity price volatility, including due to the intensification of regional conflicts and deepening fragmentation. Risks of political instability remain, even after the peaceful elections and the subsequent formation of the coalition government. On the upside, additional donor assistance could support the new government's initiatives in its priority areas.

Authorities' Views

13. The authorities broadly agreed with staff's assessment of the economic outlook and risks. They emphasized their commitment to sustainable and inclusive growth, in particular by promoting investment and improving connectivity in rural areas outside of the main island. While expecting a somewhat steeper moderation in inflation, the authorities acknowledged that the recent spike in fuel prices and other supply-side factors may necessitate revisiting their outlook. On the external side, the projections of the authorities and staff are generally aligned, especially regarding the persistent current account deficit and relatively stable foreign exchange reserves. The authorities recognized the risks of continued fiscal deficits and depleted cash buffers, increased vulnerability to natural disasters, and volatility in global commodity prices, while noting that deepening geoeconomic fragmentation could adversely affect the economy.

ECONOMIC POLICIES

A. Fiscal Policy

14. The government needs to take immediate steps to improve the resilience and quality of its fiscal policy in order to position itself well to address medium-term challenges. Accelerating public investment in physical and human capital remains a priority to boost growth and eradicate poverty. However, the following four fiscal challenges require urgent action:

- **Rebuilding the cash balance.** A concrete plan is needed immediately, given the liquidity risk and the country's vulnerability to shocks. However, the pace of the restoration needs to be gradual, as growth is still below potential, the fiscal space is limited, and the shallow domestic market precludes one-off borrowing to quickly rebuild the balance. Staff's recommendation to restore the broader cash balance to at least two months of total spending remains valid.
- **Ending the practice of unfunded spending.** The prepared budgets have had financing gaps since 2021. This has led to repeated cash shortages and spending cuts in the middle of the year, undermining the conduct of fiscal policy.
- **Improving the quality of public spending.** Unfunded budgets have severely compromised the quality of public spending, undermining the ability of government agencies to implement policies and deliver services as planned. The fragmented implementation of development projects between the government, development partners, and parliamentarians (CDFs) suggests that there is scope to rationalize spending, without sacrificing growth, through better integration and targeting.
- **Imposing fiscal discipline on domestic borrowing.** The rapid increase in domestic borrowing has been a major driver of the deterioration of the government's financial position in recent years (see text chart in paragraph 7). This raises concerns about the sustainability of domestic financing, given the narrow investor base and the underdeveloped financial market.

15. Filling fundamental gaps in fiscal data and public financial management (PFM) is an essential first step in tackling these challenges. For instance, the 2022 and 2023 budget outturns were not published until November 2024, and the government does not publish fiscal data on a monthly or quarterly basis (see Selected Issues Paper "Strengthening Fiscal Data Governance in Solomon Islands"). In such circumstances, preparing a robust and feasible budget and effectively monitoring its implementation become almost impossible. Immediate action by the government is required to remedy this situation, including:

- Resume the publication of fiscal reporting and debt data on a monthly and quarterly basis.
- Discuss and request training from donors for using the public finance module of D365, the recently upgraded Financial Management Information System.
- Strengthen cash management and forecasting by monthly reconciling accounts and obtaining cash projections from ministries.

- Review the budget process to better estimate the budget envelope, including donor support and domestic financing, and to eliminate funding gaps in budget proposals.
- Prepare and publish budget documents in a timely manner, including the medium-term fiscal strategy, budget strategy, mid-year budget review, and budget outcomes.

Many of these actions are resumptions of previous practices and were recommended by past IMF technical assistance (TA). Staff strongly urges the authorities to implement these recommendations, with support from IMF TA as needed.

16. The current debt ceiling remains broadly appropriate, while there is no effective operational rule to guide fiscal policy consistently with the medium-term anchor. Staff analysis shows that the current 35 percent debt-to-GDP ratio threshold remains broadly appropriate as a medium-term debt ceiling. However, current operational fiscal rules (e.g., golden rule, annual borrowing limit) have not effectively guided fiscal policy due to their complexity, limited transparency, and weak monitoring (see Selected Issues Paper "Enhancing effectiveness of Solomon Islands' Fiscal Framework"). As a result, government-funded expenditures are budgeted on a bottom-up basis, driven by each ministry's estimates, with no effective top-down controls on aggregate spending.

17. Staff proposes the introduction of a simple ex-ante guideline for annual budget formulation as an interim measure. The lack of a basic PFM foundation suggests that the government is not ready to implement a full-fledged and binding operational fiscal rule: considerations of donor-supported projects are not integrated into the annual budget process,[5] and credible budget data are not available on a timely basis to track the implementation of the fiscal rule. Therefore, staff proposes that the government adopt a simple ex-ante guideline for annual budget formulation, consistent with a potential fiscal rule to ensure fiscal sustainability, as an interim measure while it develops sufficient PFM capacity. Such a guideline would force the government to prioritize expenditures within the envelope when preparing a budget proposal, rather than cutting spending during the fiscal year in the face of a cash crunch.

18. Staff proposes that the guideline set a ceiling on the primary budget deficit financed by domestic borrowing. In other words, the ceiling would apply to the balance between domestic revenues (i.e., tax and other revenues) and primary spending financed by these resources: such spending is under the control of the government and can be reliably estimated at the stage of a budget proposal. Staff analysis indicates that the government would need to maintain the domestically financed primary deficit at around 0.3 percent of GDP until 2029. This assumes that the government would borrow domestically by 0.5 percent of GDP each year from 2025 to 2029 to rebuild the broader cash balance to 2 months of total spending, in addition to borrowing to finance budget deficits. The proposed guideline is consistent with a potential fiscal rule that maintains

[5] In Solomon Islands, the majority of donor support (i.e. grants and concessional loans) is provided and managed off-budget.

public debt below the authorities' threshold until 2040[6] (see the above-mentioned Selected Issues Paper).

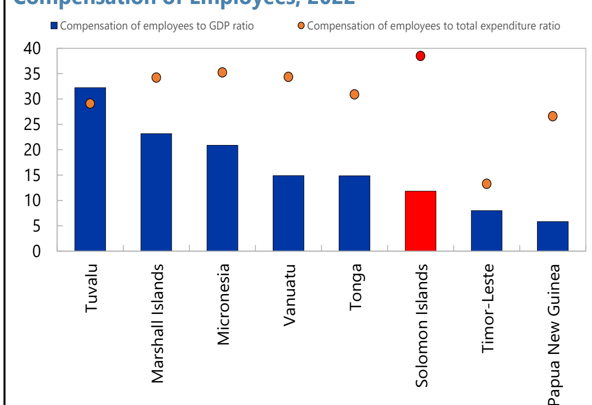
Solomon Islands: Fiscal Balance and Financing
(Percent of GDP)

	2020	2021	2022	2023	2024	2025		2026		2027		2028		2029	
						Baseline	Guideline	Baseline	Guideline	Baseline	Guideline	Baseline	Guideline	Baseline	Guideline
Primary Balance	-2.2	-1.6	-2.2	-3.5	-2.6	-2.7	-2.1	-2.6	-2.1	-2.4	-2.1	-2.3	-2.1	-2.3	-2.1
Domestically financed	-0.8	-0.5	-2.1	-0.6	-0.4	-0.9	-0.3	-0.7	-0.2	-0.5	-0.2	-0.5	-0.3	-0.5	-0.3
Externally financed	-1.4	-1.1	-0.1	-2.9	-2.3	-1.8	-1.8	-1.9	-1.9	-1.9	-1.9	-1.8	-1.8	-1.8	-1.8
Less: Interest expense	0.2	0.2	0.3	0.3	0.5	0.5	0.5	0.6	0.6	0.7	0.7	0.7	0.8	0.8	0.9
Overall Balance	-2.4	-1.9	-2.5	-3.8	-3.1	-3.3	-2.7	-3.2	-2.7	-3.1	-2.8	-3.1	-2.9	-3.1	-3.0
Financial Transactions	2.4	1.9	2.5	3.8	3.1	3.3	2.7	3.2	2.7	3.1	2.8	3.1	2.9	3.1	3.0
Liabilities:	2.4	1.9	2.5	3.8	3.1	3.3	3.2	3.2	3.2	3.1	3.3	3.1	3.4	3.1	3.5
Domestic	1.0	0.7	2.4	0.9	0.8	1.5	1.3	1.3	1.3	1.2	1.4	1.2	1.6	1.3	1.7
External	1.4	1.1	0.1	2.9	2.3	1.8	1.8	1.9	1.9	1.9	1.9	1.8	1.8	1.8	1.8
Less: Assets: Cash Balance							0.5		0.5		0.5		0.5		0.5

Source: IMF Staff Estimates

19. The government should assess ex-post whether the budget was implemented in line with the guideline. As the proposed guideline is not intended to be a permanent fiscal rule, strict compliance, such as through legislation, would not (and cannot) be required. The government could decide to adopt the guideline, for instance, by a cabinet decision. It is important that the government reviews the implementation of the guideline ex post and explains the reasons for deviations from the guideline in its budget outcome report. The government should also regularly assess if public finances are moving in line with the medium-term fiscal anchor in its medium-term fiscal strategy.

Compensation of Employees, 2022



Sources: IMF World Economic Outlook and IMF staff calculations.

20. There is room to rationalize spending without compromising growth through better planning and targeting. The proposed guideline suggests that the government needs to create additional fiscal space of 0.6 percent of GDP in 2025, relative to the staff baseline (see text table in paragraph 18). Shifting resources away from the CDFs would increase the coherence and efficiency of public spending towards national development goals. For example, keeping the 2025 contribution to the

[6] The potential rule indicates that the government should target a primary fiscal deficit of 2.1 percent of GDP from 2025 to 2029 (taking into account externally financed infrastructure projects expected to remain at 1.8-1.9 percent of GDP during the period) and 0.5 percent of GDP from 2030 onwards.

CDFs at the 2024 level[7] could save the budget 0.6 percent of GDP. The government payroll has grown by 2.5 percent of GDP over the past five years, with further increases expected for government employees such as police officers. The government, in coordination with development partners, should assess the appropriate size, allocation, and remuneration of its workforce. While current spending on education and health is insufficient, there remains an opportunity for efficiency gains to achieve better outcomes.[8]

21. Domestic revenue mobilization is essential for accelerating investment in development priorities. While government revenues remain below pre-pandemic levels, due to declining logging activity, there is scope to mobilize further revenues in the medium term by improving the accuracy and coverage of taxpayer registration, ensuring compliance, and tightening exemptions.[9] Staff commends the government's commitment in the 100-Days Program to strengthen revenue sources and address tax leakages and inefficiencies, but recommends against an increase in the personal income tax exemption threshold, which is being discussed in the government. The government should prioritize passing the VAT Bill and prepare for its implementation in early 2026, while the planned review of the Income Tax Act would be a good opportunity to strengthen the tax system in the medium term. The Inland Revenue Division (IRD) should pursue comprehensive modernization, focusing on digital transformation and tax risk management. Ensuring tax compliance from mining companies and avoiding further tax exemptions in mining negotiations could generate tax revenues down the road. The government would benefit from developing a medium-term revenue mobilization plan, which would provide a comprehensive roadmap for revenue mobilization, building on ongoing reforms.

22. Enhancing the transparency and accountability of public spending remains a priority. Staff welcomes the adoption of the new CDFs Act[10] and the Public Investment Management Framework and emphasizes the importance of consistent implementation of these new frameworks.[11] Several regulations under the Public Financial Management Act (PFMA) 2013 have yet to be finalized, and the last audited financial statements of the government date back to 2018, on which the auditor did not express an opinion due to a lack of supporting documentation and non-

[7] The government contribution to the CDFs was reduced from SI$261 million in the 2023 budget to SI$200 million in the 2024 budget, in light of the parliamentary election in April 2024.

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

[9] Staff's baseline assumes efficiency gains from the reform of the tax administration and the introduction of a value-added tax (VAT), as well as increased revenues from mining exports, offsetting the decline in revenues from log exports.

[10] The new CDFs Act 2023, passed by Parliament in December 2023, is intended to strengthen the governance of the CDFs (e.g., establishing a committee to decide on programs), ensure effective delivery mechanisms (e.g., requiring a procurement process in accordance with the PMFA 2013), and promote inclusiveness (e.g., ensuring that two females serve as members of the committee).

[11] Immediate challenges for the implementation of the new CDFs Act include the establishment of implementing officers and bodies and the development of data to measure results.

compliance with reporting requirements under the PFMA. Staff commends the publication of the audit report on the Economic Stimulus Package (ESP), which illustrates Solomon Islands' fundamental weaknesses in the transparency and accountability of public spending. The government should develop guidelines for grant programs to ensure that the report's recommendations are applied to future programs. It is important to enhance the capacity and resources of government officials involved in procurement. Strengthening auditing is also important, including through training and improving the legal framework to ensure the independence of the Office of the Auditor General.

Authorities' Views

23. The authorities agreed on the need to address the fiscal challenges and improve the transparency and accountability of public spending. While acknowledging the larger fiscal deficit expected in 2025, the government reaffirmed its commitment to gradually reduce deficits and ensure debt sustainability. To achieve this, the government is committed to introducing a fiscal anchor and a VAT, reviewing income taxes and non-tax revenue sources, modernizing tax administration, and updating the medium-term debt management strategy. Additionally, it is committed to implementing the recommendations from the audit report on the ESP, as promised in the report, and to enhancing its audit capacity through legislation and training. The government also intends to improve the publication and presentation of fiscal data in compliance with the PFMA and will undertake a Public Expenditure and Financial Accountability (PEFA) assessment in partnership with PFTAC in 2025 to review its PFM practices.

B. Monetary and Exchange Rate Policy

24. The CBSI should remain vigilant to economic developments, while maintaining its autonomy. Staff supports the CBSI's recent decision to notionally ease monetary policy, considering the stable inflation outlook, below-potential growth, and ample foreign reserves. The CBSI should continue to stand ready to adjust its monetary policy stance as economic conditions evolve. On the other hand, staff believes that the purchases of government bonds in late 2023 and early 2024 are not justified in light of the CBSI's mandates and economic conditions. This highlights the importance of maintaining safeguards for the purchase of government securities both in the primary and secondary market.[12]

25. The implementation of recommendations from the 2022 safeguards assessment has been slow. Nearly half of the recommendations remain outstanding. While external audit arrangements were recently enhanced, independent oversight by the Board Audit Committee continues to need strengthening. Stepped up efforts will also be necessary to improve risk management, internal controls, internal audit capacity, and the financial autonomy of the CBSI.

[12] The CBSI Act was amended in November 2023, which included a provision to allow the CBSI to buy and sell the Treasury bills in the primary market for monetary policy purposes, contrary to the recommendation by IMF TA.

26. There is scope to further improve foreign exchange operations and communication to market participants. Staff welcomes the recent update of the currency basket of the exchange rate regime in August 2024, reflecting the latest trade structure, consistent with IMF TA recommendations.[13] It is important that the regime continues to be managed fully in line with the basket and that the basket is reviewed periodically to ensure that the regime helps the CBSI to pursue price stability. The central bank should further improve its foreign exchange operations and communication with market participants, for example, by initiating regular meetings with market participants and introducing intraday pricing to support price discovery, in line with the recent IMF TA recommendations.

Authorities' Views

27. The authorities are committed to price stability and transparent implementation of the exchange rate regime. The CBSI will continue to closely monitor economic developments and adjust its policy stance as needed. The central bank does not anticipate further purchases of government bonds in the current economic conditions, although it does not rule out the possibility of taking measures to stabilize the market in exceptional circumstances. The central bank will continue to strengthen its audit function, risk management, and conflict of interest policies, in line with the Safeguards Assessment recommendations. The CBSI is committed to keep the exchange rate regime fully in line with the revised currency basket and to implement the remaining TA recommendations with a view to further improving the transparency of foreign exchange operations and communication with market participants. The authorities broadly agreed with the conclusions of the ESA, including the need to diversify exports, improve competitiveness, and periodically review the currency basket.

C. Financial Sector Policy

28. Solomon Islands' financial sector remains stable, although some structural risk factors remain. Commercial banks remain well capitalized and profitable. Their asset quality has slightly deteriorated, with the non-performing loan ratio rising to 10.6 percent in the first half of 2024, partly because delayed government payments to local service providers, due to a cash crunch, have limited their ability to repay their loans on time. Delays in the registration of collateral and the lengthy court process for debt recovery have remained obstacles to the expansion of bank lending. The Solomon Islands National Provident Fund, the country's only superannuation fund, has maintained positive earnings and adequate liquidity. However, rising demand for early withdrawals and undiversified asset allocation due to limited investment opportunities[14] pose significant risks. Upgrading regulatory and supervisory frameworks for financial institutions, including the superannuation

[13] The Solomon Islands dollar is pegged to an invoice-based weighted basket of currencies consisting of the US dollar, the Australian dollar, and the New Zealand dollar. The IMF provided TA to the CBSI in April 2024 to review the currency basket framework and the foreign exchange operations.

[14] Unlisted shares accounted for 40 percent of the fund's investment assets in the first half of 2024.

sector, credit unions, and the Development Bank of Solomon Islands, remains a priority.

29. Policy reforms in a wide range of areas are needed to promote financial inclusion. Access to financial services in Solomon Islands remains limited and is lagging its peers in the Pacific region, especially in rural areas and among women (Annex IV). To improve the efficiency of transactions and facilitate the introduction of digital financial services, the authorities should expedite the finalization of regulations to operationalize the National Payments Systems Act and the integration of the government's accounting system into the Automated Transfer System. Further reform efforts by all stakeholders are needed to improve financial inclusion: necessary reforms include improving access to affordable electricity and the internet, developing a national identity platform[15], enhancing financial and digital literacy, and strengthening consumer protection.

30. Enhancing capacity for anti-money laundering and combating the financing of terrorism (AML/CFT) remains a priority. Correspondent banking relationship (CBR) pressures have been relatively muted in Solomon Islands so far. However, there is no room for delay in addressing AML/CFT weaknesses, given the regional trend of declining provision of CBR services. Enactment of the Money Laundering and Proceeds of Crime Act and its regulations should be expedited to address deficiencies identified by the Asia-Pacific Group on Money Laundering in 2019 and subsequent changes to the FATF Standards. The introduction of a risk-based supervisory tool, with support of the IMF, is needed to enhance the effectiveness of AML/CFT supervision of financial institutions. The planned introduction of the Citizenship by Investment program[16] adds urgency to strengthening AML/CFT capacity. Without a rigorous due diligence process, transparent and effective oversight, and mitigation of financial integrity risks, the program could create serious risks, including reputational damage, volatile revenues, and the potential loss of CBRs.

Authorities' Views

31. The authorities agreed that enhancing financial inclusion and safeguarding the integrity and stability of the financial system are crucial. The CBSI emphasized that leveraging digital financial technologies such as mobile money services and the new payment system, including through digitization of government transaction processes, should accelerate financial inclusion. The central bank is committed to strengthening its supervisory capacity for financial institutions and AML/CFT, while noting the critical importance of legislation of the frameworks for these objectives. The government expressed its commitment to developing robust and multi-layered due diligence mechanisms for the planned Citizenship by Investment program, drawing on the experience of other countries.

[15] In June 2024, the government initiated a program to register all SIM card information in a single registry, under the Telecommunications (Amendment) Act 2021, which is the first step towards a national identity platform.

[16] The program is supposed to allow individuals to obtain Solomon Islands citizenship and passports by making certain investments, although details are yet to be announced.

D. Structural Reforms

32. Persistently anemic growth on the back of limited diversification of the economy necessitates urgent policy action to enhance competitiveness and boost private sector participation. Promoting land registration and improving access to dispute resolution mechanisms would encourage private sector participation. Staff analysis suggests that Solomon Islands could see some additional income growth from emigration and financial inclusion, particularly by addressing infrastructure gaps, improving the business environment, expanding digital connections, and enhancing the quality of education and training (Annex III and IV). The prevalence of subsistence agriculture and fisheries with limited use of capital suggests that there is scope for significant productivity gains in these sectors through targeted mechanization and improved connectivity (World Bank 2024, Solomon Islands: Country Economic Memorandum—Unlocking New Sources of Economic Growth).

33. The government's commitment to address governance weaknesses and combat corruption must be backed by concrete policy measures. The launch of the updated National Anti-Corruption Strategy is welcome; it is important to steadily implement the action plan and monitor the implementation, including increasing the resources and strengthening the independence of the Independent Commission Against Corruption, in coordination with development partners. There has been no significant progress in addressing the governance weaknesses in the extractive industries discussed in the 2023 Article IV Staff report. Ministries still lack the resources to effectively oversee logging and mining activities, and legislation to improve governance frameworks is still pending.

34. Climate change poses a macro-critical threat to Solomon Islands. Staff estimates that the country would need additional spending of about 6.9 percent of 2030 GDP every year, to address climate adaptation needs while achieving key Sustainable Development Goals (SDGs) (see IMF Country Report No. 22/15). While the authorities' efforts to improve access to climate finance are welcome, addressing fundamental gaps in PFM, as discussed in paragraph 15, is a prerequisite for effective planning and implementation of climate investments.

Authorities' Views

35. The authorities are committed to unlocking growth potential in an inclusive manner by strengthening the rural economic base and addressing governance weaknesses. The government emphasized the importance of enhancing the productivity of the primary sector outside the main island by promoting investment, raising the awareness of the rural population, and improving access to finance and connectivity to markets. Addressing governance weaknesses in the forestry and mining sectors, including through legislation, remains a priority for the authorities, while the lack of resources and capacity is a bottleneck. The government is committed to implementing the National Anti-Corruption Strategy Action Plan, including strengthening the capacity of key integrity and justice institutions.

DATA ISSUES AND CAPACITY DEVELOPMENT

36. Data provided by the authorities to the Fund has some shortcomings that somewhat hamper surveillance (Annex VII). GDP estimates for 2021 and 2022 and the outcomes of the 2022 and 2023 budgets were not published until February 2024 and November 2024, respectively. The Ministry of Finance and Treasury (MoFT) has stopped publishing fiscal data on a monthly and quarterly basis. A new financial management information system introduced during the pandemic has hindered the processing of granular data and, consequently, the compilation of the GFS by the CBSI[17] (see Selected Issues Paper "Strengthening Fiscal Data Governance in Solomon Islands"). The IMF and other development partners have provided a series of TA to address the capacity constraints, which should be continued (see the paragraph below).

37. The Country Engagement Strategy suggests that IMF support for capacity development (CD) should continue to focus on the basic capacity of state institutions (see Annex III in the 2023 Solomon Islands Article IV Staff Report). Immediate CD needs include the following:

- **MoFT.** The urgent priority is to review PFM practices and address the weaknesses, in particular the budget process and fiscal data. Developing the domestic debt market also remains a priority. The Ministry should start preparing to develop its medium-term revenue mobilization plan.
- **SINSO.** The agency needs continued support for the compilation of basic macroeconomic statistics, in particular the national accounts.
- **CBSI.** The central bank should continue to strengthen its frameworks and capacity for internal audit and risk management, economic analysis and forecasting, monetary policy communication, supervision of financial institutions, and AML/CFT.

Authorities' Views

38. The authorities broadly agreed with staff's data adequacy assessment and proposed CD priorities. The authorities acknowledged the need to improve the quality and timeliness of statistics, in particular the national accounts and the GFS, and requested IMF continuous support for the SINSO and other relevant agencies. The government is committed to strengthening its PFM practices and is working with PFTAC to conduct a PEFA assessment in 2025. The CBSI requested CD support to improve the effectiveness of its monetary policy tools, as part of its ongoing capacity building efforts with the IMF.

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[17] In addition, the GFS compiled by the CBSI lacks information on government financing.

STAFF APPRAISAL

39. The authorities have successfully overcome a series of shocks and achieved the historic feat of hosting the Pacific Games and conducting peaceful general elections. The country should build on these achievements to advance reforms to address the long-standing challenge of stagnant income growth, while ensuring fiscal sustainability.

40. Staff expects continued modest growth after the Pacific Games, while structural factors weigh on medium-term growth prospects. Modest growth in 2025 is expected to be driven by the fishing, mining, manufacturing, and construction sectors. Declining logging activity and the undiversified economic base with weak governance constrain the growth potential. Inflation is projected to remain stable, while fiscal and current account deficits are expected to persist in the medium-term, reflecting declining log exports and large infrastructure projects. Solomon Islands' external position in 2023 was assessed as weaker than the level implied by fundamentals and desirable policies, highlighting the need to diversify exports and improve competitiveness. Reserve coverage is expected to keep declining, but remain within the adequacy range, supported by continued aid inflows.

41. Enhancing the effectiveness of fiscal policy is an urgent challenge. The first step is to fill fundamental gaps in fiscal data and PFM, including (i) resuming the periodical reporting of fiscal and debt data by the government; (ii) strengthening cash management and forecasting; and (iii) reviewing the budget process to eliminate a financing gap in the budget proposal. To guide annual budget formulation, staff proposes the introduction of a simple ex-ante guideline setting a ceiling on the primary budget deficit financed by domestic borrowing. The 2025 budget should be tightened to start a gradual recovery of the cash balance, including by shifting resources away from the CDFs. Domestic revenue mobilization is essential to accelerate investment in development priorities: the government should prioritize the introduction of the VAT, while there is scope to mobilize revenues in the medium term by improving taxpayer registration, ensuring compliance, and tightening exemptions.

42. Improving the transparency and accountability of public spending remains a priority. Staff welcomes the adoption of the new CDFs Act and the publication of the audit report on the ESP and stresses the importance of the consistent implementation of the Act and the lessons learned from the report. It is important to strengthen the capacity and resources of government officials involved in procurement and auditing through training and strengthening the legal framework for auditing.

43. The central bank should remain vigilant to economic developments, while maintaining its autonomy. The CBSI should continue to stand ready to adjust its monetary policy stance as economic conditions evolve. It should avoid further purchases of government bonds, given the current economic conditions, while ensuring that safeguards are in place for the purchase of government securities in the primary and secondary market.

44. There is scope to improve the operation of the exchange rate regime. Staff welcomes the recent update of the currency basket and underlines the importance of the exchange rate regime being managed in line with the basket. The central bank should further improve its foreign exchange operations and communication with market participants, for example by initiating regular meetings with market participants and introducing intraday pricing to support price discovery.

45. Improving financial inclusion and integrity remains essential. While the financial sector remains stable, growth of bank lending has not kept pace with economic trends. Reforms to expand the supply of digital financial services, such as improving access to affordable internet and electricity and upgrading digital and financial literacy, are needed to enhance financial inclusion, especially among women and in rural areas. Strengthening legal and supervisory frameworks for AML/CFT should be expedited. Staff urges careful consideration in the introduction and implementation of the Citizenship by Investment program, given the limited AML/CFT capacity.

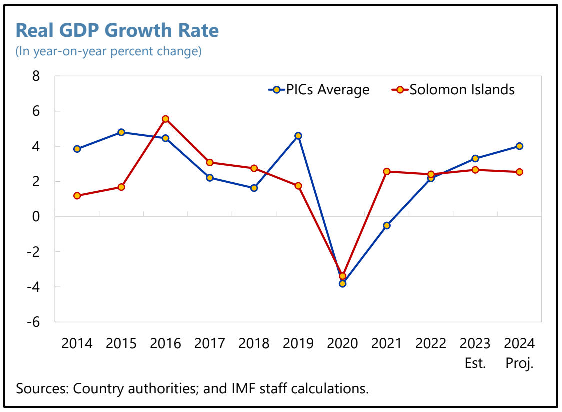
46. Comprehensive and sustained reform measures are needed to bolster long-term growth prospects. There is scope for significant productivity gains in the agriculture and fisheries sectors through targeted mechanization and improved connectivity in rural areas. The government should steadily implement the National Anti-Corruption Strategy Action Plan, including enhancing the capacity of anti-corruption institutions. Concrete action is urgently needed to address governance weaknesses in the forestry and mining sectors, in particular amending legal frameworks and increasing resources for monitoring.

47. The IMF continues to support capacity development of the authorities in collaboration with development partners. Immediate CD priorities include fiscal reporting and auditing, PFM, AML/CFT, and statistics especially the national accounts and GFS.

48. 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

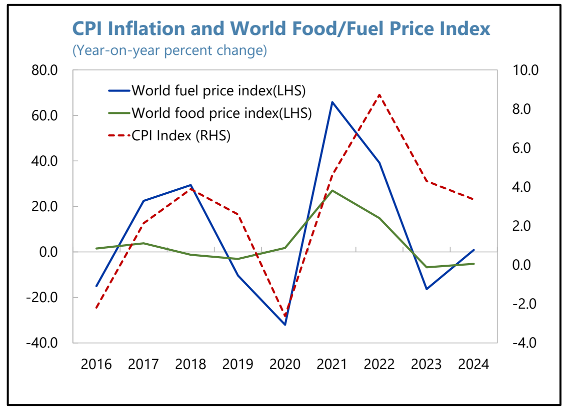
The post-pandemic recovery continues, albeit at a slower pace than regional peers.



Real GDP Growth Rate
(In year-on-year percent change)

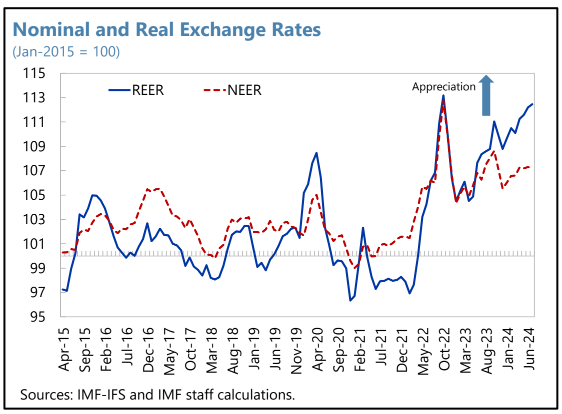
Sources: Country authorities; and IMF staff calculations.

Inflation is on a downward trend, as global food and energy prices have stabilized.



CPI Inflation and World Food/Fuel Price Index
(Year-on-year percent change)

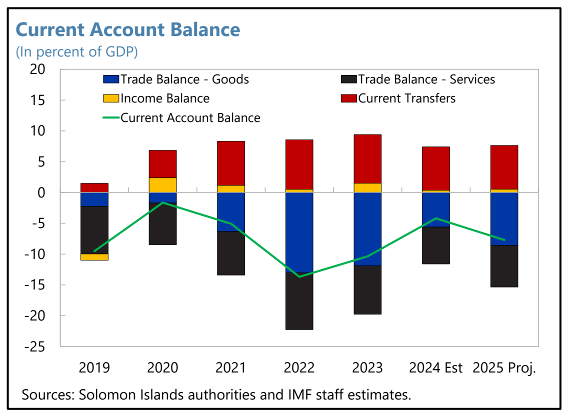
The real effective exchange rate continues to appreciate and deviate from the nominal exchange rate path.



Nominal and Real Exchange Rates
(Jan-2015 = 100)

Sources: IMF-IFS and IMF staff calculations.

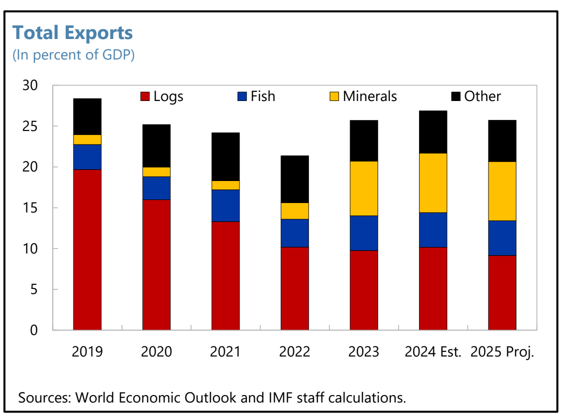
The current account deficit is expected to narrow following the Pacific Games ....



Current Account Balance
(In percent of GDP)

Sources: Solomon Islands authorities and IMF staff estimates.

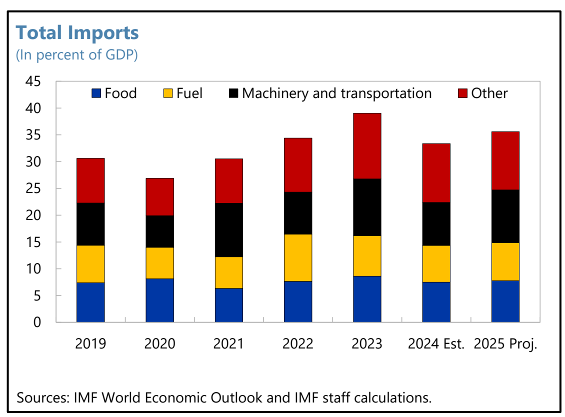
...amid strong export performance across categories...



Total Exports
(In percent of GDP)

Sources: World Economic Outlook and IMF staff calculations.

...and normalization of imports after the Games.

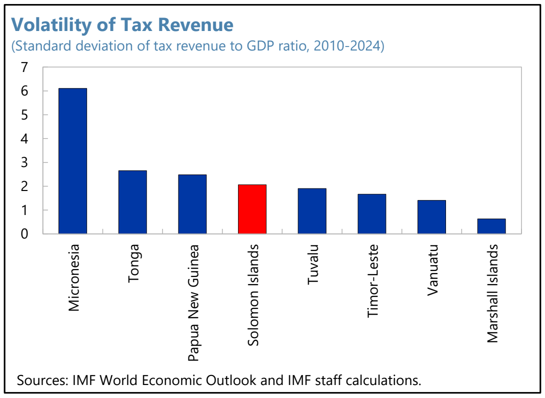


Total Imports
(In percent of GDP)

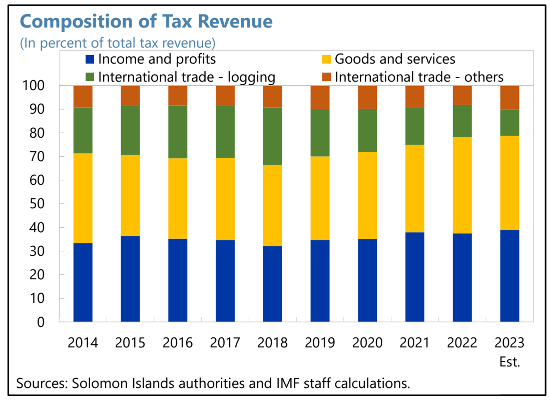
Sources: IMF World Economic Outlook and IMF staff calculations.

Figure 2. Solomon Islands: Fiscal Indicators

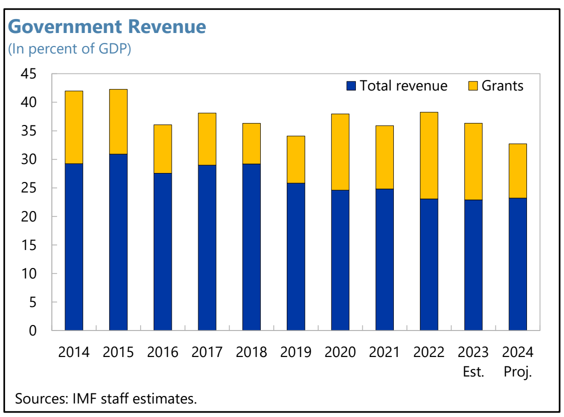
Solomon Islands tax revenue is relatively volatile…



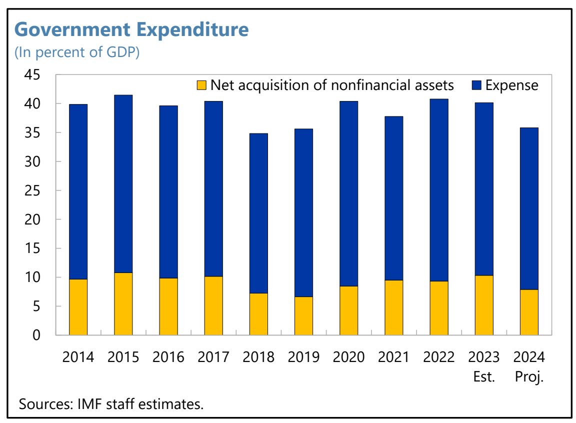
… while the share of logging revenue is declining.



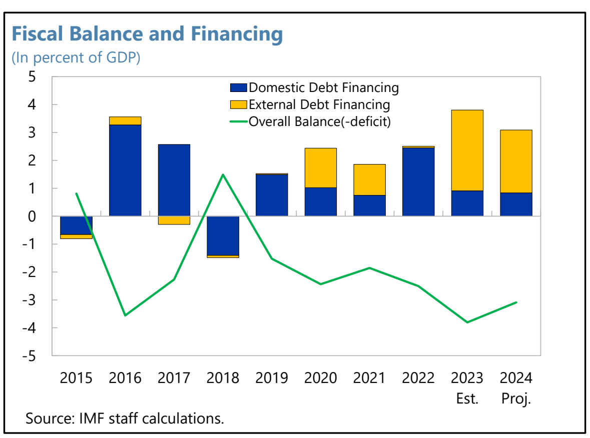
The revenue performance was affected adversely by the pandemic and declining production in the logging sector…



and expenditure was under pressure due to the Pacific Games and infrastructure projects.



Consequently, the fiscal deficit persisted…



…leading to continued increases in the public debt ratio.

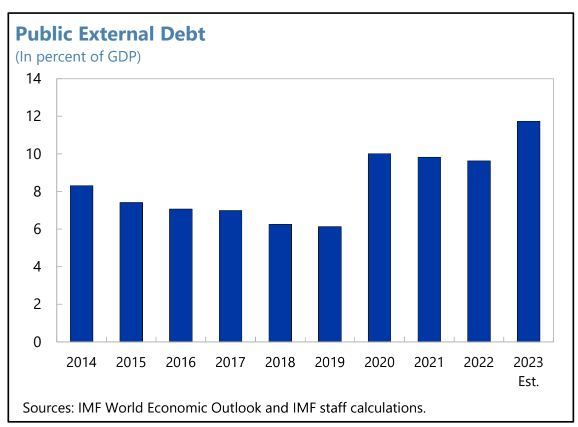
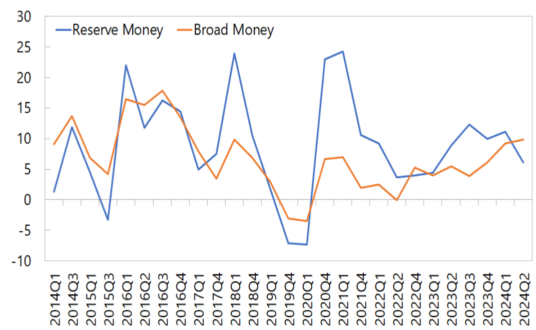


Figure 3. Solomon Islands: Money and Credit Developments

Monetary conditions remain accommodative…

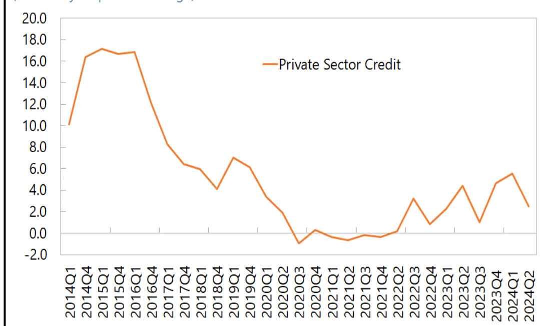
Broad Money and Reserve Money
(In year-on-year percent change)



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

…while commercial banks are gradually increasing credit to the private sector.

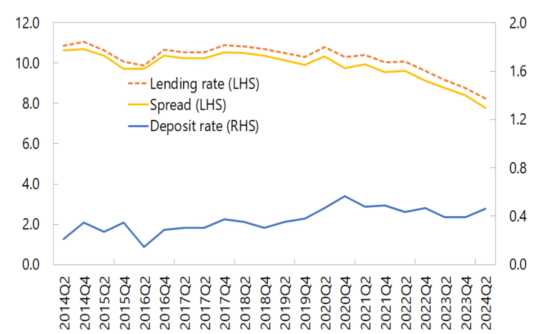
Private Sector Credit
(Year-on-year percent change)



Sources: IMF-IFS and IMF staff calculations.

Banking sector spreads are declining slowly, but remain high…

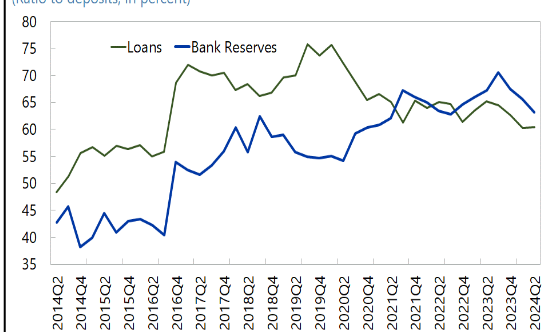
Lending and Deposit Rates
(In percent per annum)



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

…as banks have accumulated reserves.

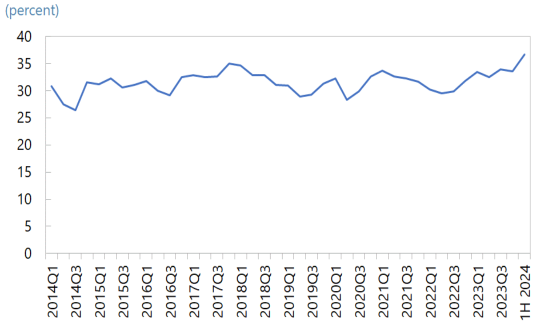
Bank Reserves and Loans
(Ratio to deposits, In percent)



Sources: IMF-IFS and IMF staff calculations.

Banks remain well capitalized…

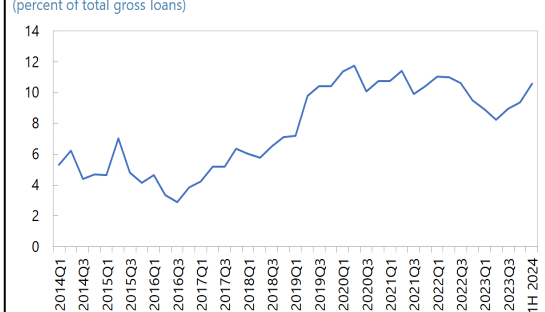
Capital to Risk-Weighted Assets
(percent)



Sources: IMF-FSI and CBSI

…while their asset quality has remained stable.

Non-perfoming Loans
(percent of total gross loans)



Sources: IMF-FSI and CBSI

Table 1. Solomon Islands: Selected Economic Indicators, 2019–2029

Per capita GDP (2023): US$2200
Population (2023): 768,690
Quota: SDR 20.8 million

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Est.			Proj.			
GROWTH AND PRICES	(In percent change, unless otherwise indicated)										
Real GDP	1.7	-3.4	2.6	2.4	2.7	2.5	2.8	2.9	2.9	3.0	3.0
CPI (period average)	2.2	2.9	0.2	5.4	5.1	3.7	3.8	3.7	3.4	3.3	3.3
CPI (end of period)	2.6	-2.6	4.6	8.7	4.3	3.4	3.9	3.5	3.3	3.3	3.3
GDP deflator	1.2	-1.3	-5.5	2.0	3.9	1.3	1.3	1.3	1.4	1.4	1.4
Nominal GDP (in SI$ millions)	13,234	12,617	12,228	12,775	13,911	14,685	15,492	16,370	17,311	18,235	19,217
Nominal GDP (in US$ millions)	1,619	1,536	1,523	1,566	1,661	1,753	1,850	1,954	2,067	2,177	2,294
CENTRAL GOVERNMENT OPERATIONS	(In percent of GDP)										
Total revenue and grants	34.1	37.9	35.9	38.3	36.3	32.7	32.5	32.6	32.7	32.8	32.8
Revenue	25.8	24.6	24.8	23.1	22.9	23.2	23.0	23.1	23.2	23.3	23.3
Grants	8.2	13.4	11.1	15.2	13.4	9.5	9.5	9.5	9.5	9.5	9.5
Total expenditure	35.6	40.4	37.8	40.8	40.1	35.8	35.7	35.8	35.8	35.8	35.9
Expense	29.0	31.9	28.3	31.4	29.8	27.9	27.2	27.3	27.4	27.4	27.5
Net acquisition of nonfinancial assets	6.6	8.5	9.5	9.3	10.3	7.9	8.5	8.5	8.4	8.4	8.4
Net lending (+) / Net borrowing (-)	-1.5	-2.4	-1.9	-2.5	-3.8	-3.1	-3.3	-3.2	-3.1	-3.1	-3.1
External	0.0	-1.4	-1.1	-0.1	-2.9	-2.3	-1.8	-1.9	-1.9	-1.8	-1.8
Domestic	-1.5	-1.0	-0.7	-2.4	-0.9	-0.8	-1.5	-1.3	-1.2	-1.2	-1.3
Central government debt 1/	7.8	12.8	15.9	15.5	20.3	22.3	24.4	26.2	27.9	29.5	31.0
Public domestic debt	1.7	2.8	6.1	5.9	8.6	8.9	9.8	10.6	11.1	11.7	12.4
Public external debt	6.1	10.0	9.8	9.6	11.7	13.4	14.5	15.6	16.7	17.7	18.6
MACROFINANCIAL	(In percent change)										
Credit to private sector	6.2	0.3	-0.4	0.8	4.6	3.0	3.0	3.0	3.0	3.0	3.0
Broad money	-3.1	6.6	1.9	5.3	5.9	6.8	5.5	5.7	5.8	5.3	5.4
Reserve money	-7.1	23.0	10.6	4.0	9.6	6.0	5.5	5.7	5.8	5.3	5.4
BALANCE OF PAYMENTS	(In percent of GDP, unless otherwise indicated)										
Current account balance	-9.5	-1.6	-5.1	-13.7	-10.4	-4.2	-7.7	-7.5	-7.4	-7.5	-7.4
Trade balance (goods and services)	-10.0	-8.5	-13.4	-22.3	-19.8	-11.6	-15.3	-15.3	-15.6	-16.1	-16.5
Exports	36.4	28.5	26.9	25.8	32.6	34.6	33.2	32.8	32.1	31.4	30.7
Imports	46.4	37.0	40.4	48.1	52.3	46.2	48.6	48.1	47.7	47.5	47.2
Gross Remittances	1.1	1.5	2.1	3.3	3.7	3.5	3.6	3.8	3.9	4.1	4.3
Capital and Financial Account	7.3	3.0	6.7	13.2	13.6	4.0	6.9	7.3	7.5	7.5	7.5
Foreign direct investment (+ = decrease)	-1.8	-0.4	-1.5	-2.6	-4.3	-0.9	-2.3	-2.6	-2.7	-2.8	-2.9
Overall balance (+ = increase)	-2.1	4.8	2.5	-2.0	3.3	-0.2	-0.8	-0.2	0.1	0.0	0.1
Gross official reserves (in US$ millions, end of period) 2/	574.1	660.6	694.5	655.2	682.0	679.1	664.3	661.0	662.8	663.2	664.6
(in months of next year's imports of GNFS)	12.1	12.9	11.1	9.0	10.1	9.1	8.5	8.0	7.7	7.4	7.0
EXCHANGE RATE (SI$/US$, end of period)	8.2	8.0	8.1	8.3	8.5	...	...	...	...	...	...
Real effective exchange rate (end of period, 2010 = 100)	127.5	129.9	124.8	132.3	136.0	...	...	...	...	...	...

Sources: Data provided by the authorities; and IMF staff estimates and projections.
1/ Includes disbursements under the Rapid Credit Facility (RCF).
2/ Includes SDR allocations made by the IMF to Solomon Islands in 2009 and in 2021.

Table 2a. Solomon Islands: Summary of Fiscal Accounts, 2019–2029
(in millions of Solomon Islands dollars)

	2019 Act.	2020 Act.	2021 Est.	2022 Est.	2023 Est.	2024 Proj.	2025 Proj.	2026 Proj.	2027 Proj.	2028 Proj.	2029 Proj.
Revenue	4,510	4,788	4,391	4,887	5,054	4,805	5,031	5,335	5,657	5,972	6,304
Tax	2,942	2,656	2,681	2,680	2,956	3,137	3,273	3,476	3,692	3,902	4,123
Income, profits, and capital gains	1,006	918	994	983	1,053	1,126	1,188	1,255	1,336	1,414	1,494
Goods and services	1,024	959	973	1,066	1,202	1,219	1,286	1,359	1,454	1,532	1,624
International trade and transactions	870	737	657	574	642	746	751	812	849	900	945
Of which: Taxes on exports: Logging	581	477	406	357	316	342	325	330	339	353	355
Of which: Taxes on exports: Mining	0	0	0	15	15	23	32	42	53	65	79
Not elsewhere classified	41	42	59	58	59	46	48	50	53	56	59
Grants	1,091	1,685	1,356	1,941	1,869	1,395	1,472	1,555	1,645	1,732	1,826
Other revenue	477	447	353	265	229	273	287	303	321	338	356
Expenditure	4,712	5,095	4,618	5,207	5,583	5,259	5,536	5,858	6,194	6,530	6,893
Expense	3,836	4,026	3,456	4,016	4,147	4,099	4,219	4,467	4,739	4,998	5,279
Compensation of employees	1,393	1,467	1,353	1,636	1,768	1,762	1,859	1,964	2,079	2,188	2,307
Interest	20	25	27	44	41	69	80	93	117	131	152
Use of goods and services	2,118	2,121	1,584	1,891	1,865	1,762	1,782	1,883	1,991	2,097	2,210
Subsidies and grants	125	150	179	162	172	184	192	204	215	227	239
Social benefits	47	55	66	60	63	68	71	75	79	84	88
Other expense	133	208	248	224	238	254	235	248	258	272	283
Net/gross acquisition of nonfinancial assets	876	1,069	1,162	1,191	1,436	1,160	1,317	1,391	1,454	1,532	1,614
Gross/Net operating balance 1/	675	761	934	871	907	706	812	868	918	974	1,025
Primary balance	-181	-283	-201	-277	-488	-385	-425	-431	-420	-427	-437
Net lending (+) / Net borrowing (-)	-202	-308	-227	-320	-529	-454	-505	-524	-537	-558	-589
External	-4	-179	-136	-8	-403	-331	-279	-308	-335	-333	-341
Domestic	-198	-129	-92	-313	-127	-123	-226	-216	-201	-225	-249
Memorandum items:											
Nominal GDP	13,234	12,617	12,228	12,775	13,911	14,685	15,492	16,370	17,311	18,235	19,217
Broader cash balance	346	326	257	367	200	…	…	…	…	…	…
in months of total spending 2/	0.9	0.8	0.7	0.8	0.4	…	…	…	…	…	…
Public domestic debt	223	358	748	751	1,192	1,307	1,524	1,732	1,925	2,142	2,382
Accumulated domestic arrears	0	100	96	45	0	0	0	0	0	0	0
Constituency Development Fund (CDF) expenditure	181	240	337	238	261	200	300	300	300	300	300

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

1/ Defined as revenue minus expense

2/ Broader cash balance is defined as the sum of usable cashes in reserve and operationg accounts for general government purposes. Total spending is defined as total expenditure, excluding grant-funded expenditure.

Table 2b. Solomon Islands: Summary of Fiscal Accounts, 2019–2029
(in percent of GDP)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
	Act.	Act.	Est.	Est.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Revenue	34.1	37.9	35.9	38.3	36.3	32.7	32.5	32.6	32.7	32.8	32.8
Tax	22.2	21.1	21.9	21.0	21.2	21.4	21.1	21.2	21.3	21.4	21.5
Income, profits, and capital gains	7.6	7.3	8.1	7.7	7.6	7.7	7.7	7.7	7.7	7.8	7.8
Goods and services	7.7	7.6	8.0	8.3	8.6	8.3	8.3	8.3	8.4	8.4	8.4
International trade and transactions	6.6	5.8	5.4	4.5	4.6	5.1	4.8	5.0	4.9	4.9	4.9
Of which: Taxes on exports: Logging	4.4	3.8	3.3	2.8	2.3	2.3	2.1	2.0	2.0	1.9	1.8
Of which: Taxes on exports: Mining	0.0	0.0	0.0	0.1	0.1	0.2	0.2	0.3	0.3	0.4	0.4
Not elsewhere classified	0.3	0.3	0.5	0.5	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Grants	8.2	13.4	11.1	15.2	13.4	9.5	9.5	9.5	9.5	9.5	9.5
Other revenue	3.6	3.5	2.9	2.1	1.6	1.9	1.9	1.9	1.9	1.9	1.9
Expenditure	35.6	40.4	37.8	40.8	40.1	35.8	35.7	35.8	35.8	35.8	35.9
Expense	29.0	31.9	28.3	31.4	29.8	27.9	27.2	27.3	27.4	27.4	27.5
Compensation of employees	10.5	11.6	11.1	12.8	12.7	12.0	12.0	12.0	12.0	12.0	12.0
Interest	0.2	0.2	0.2	0.3	0.3	0.5	0.5	0.6	0.7	0.7	0.8
Use of goods and services	16.0	16.8	13.0	14.8	13.4	12.0	11.5	11.5	11.5	11.5	11.5
Subsidies and grants	0.9	1.2	1.5	1.3	1.2	1.3	1.2	1.2	1.2	1.2	1.2
Social benefits	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Other expense	1.0	1.6	2.0	1.8	1.7	1.7	1.5	1.5	1.5	1.5	1.5
Net/gross acquisition of nonfinancial assets	6.6	8.5	9.5	9.3	10.3	7.9	8.5	8.5	8.4	8.4	8.4
Gross/Net operating balance 1/	5.1	6.0	7.6	6.8	6.5	4.8	5.2	5.3	5.3	5.3	5.3
Primary balance	-1.4	-2.2	-1.6	-2.2	-3.5	-2.6	-2.7	-2.6	-2.4	-2.3	-2.3
Net lending (+) / Net borrowing (-)	-1.5	-2.4	-1.9	-2.5	-3.8	-3.1	-3.3	-3.2	-3.1	-3.1	-3.1
External	0.0	-1.4	-1.1	-0.1	-2.9	-2.3	-1.8	-1.9	-1.9	-1.8	-1.8
Domestic	-1.5	-1.0	-0.7	-2.4	-0.9	-0.8	-1.5	-1.3	-1.2	-1.2	-1.3
Memorandum items:											
Public domestic debt	1.7	2.8	6.1	5.9	8.6	8.9	9.8	10.6	11.1	11.7	12.4
Accumulated domestic arrears	0.0	0.8	0.8	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0

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

1/ Defined as revenue minus expense

Table 3. Solomon Islands: Balance of Payments, 2019–2029 1/

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Est.			Proj.			
					(In millions of U.S. dollars)						
Current account balance	-154	-25	-77	-215	-172	-74	-143	-146	-153	-163	-170
Trade balance for goods	-36	-26	-96	-204	-198	-98	-159	-166	-178	-197	-213
Exports	459	387	368	335	427	471	476	496	511	523	536
Logs	319	245	203	160	162	178	169	168	167	165	163
Fish	50	43	59	53	71	74	79	84	89	94	100
Minerals	20	18	17	31	111	128	134	141	148	155	163
Other	71	80	90	90	83	91	94	103	108	109	110
Imports	496	413	465	539	624	569	634	661	689	720	749
Food	120	125	96	120	141	127	139	145	152	159	167
Fuel	113	90	90	138	123	105	115	119	122	131	138
Machinery	128	91	152	123	173	160	184	194	203	209	216
Trade balance for services	-125	-104	-108	-145	-131	-105	-125	-134	-143	-154	-164
Exports	130	51	42	70	114	135	139	146	153	161	169
Imports	255	155	150	214	245	240	264	280	297	314	333
Primary Income balance	-17	37	18	8	25	6	10	9	11	11	12
Current transfers balance	24	68	109	126	131	123	131	144	158	176	195
Of which: Official transfers, net	54	71	99	92	83	81	85	90	95	101	107
Of which : Gross Remittances	18	22	33	52	61	61	67	74	81	89	98
Capital account balance	64	64	65	136	131	52	55	58	61	65	68
Financial account balance	-55	18	-37	-70	-96	-18	-73	-85	-94	-99	-103
Direct investment balance	-29	-6	-23	-41	-72	-15	-42	-51	-56	-62	-65
Portfolio investment balance	4	1	6	-2	4	2	2	2	2	2	2
Other investment balance	7	-33	-71	-4	-49	-5	-33	-36	-40	-39	-40
Errors and omissions	36	-20	-25	8	-54	0	0	0	0	0	0
Overall balance	-34	73	38	-31	54	-3	-15	-3	2	0	1
Financing	-34	73	38	-31	54	-3	-15	-3	2	0	1
Change in gross reserves (- = increase)	32	-44	-38	31	-49	3	15	3	-2	0	-1
Net use of IMF Credit 2/	-2	29	0	0	-5	0	0	0	0	0	0
					(In percent of GDP, unless otherwise indicated)						
Current account	-9.5	-1.6	-5.1	-13.7	-10.4	-4.2	-7.7	-7.5	-7.4	-7.5	-7.4
Trade balance for goods	-2.2	-1.7	-6.3	-13.0	-11.9	-5.6	-8.6	-8.5	-8.6	-9.0	-9.3
Exports of goods	28.4	25.2	24.2	21.4	25.7	26.9	25.7	25.4	24.7	24.0	23.4
Imports of goods	30.6	26.9	30.5	34.4	37.6	32.5	34.3	33.8	33.3	33.1	32.7
Trade balance for services	-7.7	-6.8	-7.1	-9.2	-7.9	-6.0	-6.8	-6.9	-6.9	-7.1	-7.2
Primary Income Balance	-1.0	2.4	1.2	0.5	1.5	0.4	0.5	0.4	0.5	0.5	0.5
Current transfers balance	1.5	4.4	7.2	8.0	7.9	7.0	7.1	7.4	7.6	8.1	8.5
Of which: Official transfers, net	3.4	4.6	6.5	5.9	5.0	4.6	4.6	4.6	4.6	4.6	4.7
Of which : Gross Remittances	1.1	1.5	2.1	3.3	3.7	3.5	3.6	3.8	3.9	4.1	4.3
Capital and Financial account balance	7.3	3.0	6.7	13.2	13.6	4.0	6.9	7.3	7.5	7.5	7.5
Direct investment balance	-1.8	-0.4	-1.5	-2.6	-4.3	-0.9	-2.3	-2.6	-2.7	-2.8	-2.9
Memorandum items											
Gross official foreign reserves (in US$ million) 3/	574.1	660.6	694.5	655.2	682.0	679.1	664.3	661.0	662.8	663.2	664.6
In months of next year's imports of GNFS	12.1	12.9	11.1	9.0	10.1	9.1	8.5	8.0	7.7	7.4	7.0
Gross external public debt (in percent of GDP)	6.1	10.0	9.8	9.6	11.7	13.4	14.5	15.6	16.7	17.7	18.6
Nominal GDP (in US$ millions)	1,619.2	1,536.1	1,522.8	1,566.4	1,660.8	1,753.3	1,849.6	1,954.5	2,066.9	2,177.1	2,294.4

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

Table 4. Solomon Islands: Summary Accounts of the Banking System, 2019–2026

	2019	2020	2021	2022	2023	2024 Proj.	2025 Proj.	2026 Proj.
	(In millions of Solomon Islands dollars)							
Central Bank of Solomon Islands (CBSI)								
Net foreign assets (NFA) 1/	4,580	4,949	5,039	4,894	5,235	5,176	5,051	5,024
Net international reserves (NIR)	4,696	4,662	4,636	4,467	4,516	4,499	4,374	4,346
Other NFA	-115	287	403	428	719	677	677	677
Net domestic assets (NDA)	-954	-984	-744	-444	-366	-114	269	577
Net claims on central government	-860	-784	-616	-337	-126	-140	-140	-140
Claims	6	65	186	185	261	278	278	278
Deposits	866	850	802	523	387	418	418	418
Other items (net)	-151	-180	-154	-206	-219	-218	-218	-218
Reserve money	2,852	3,509	3,880	4,036	4,425	4,691	4,948	5,229
Currency in circulation	910	1,095	1,247	1,279	1,404	1,482	1,563	1,652
Deposits of ODCs	1,934	2,409	2,626	2,755	2,956	3,140	3,312	3,500
Other deposits	8	5	6	2	65	69	73	77
Other depository corporations								
NFA of commercial banks 1/	201	364	179	295	256	259	259	259
Assets	427	504	524	603	517	520	520	520
Liabilities	226	140	344	309	261	261	261	261
NDA of commercial banks	1,317	1,145	1,094	1,120	1,084	1,307	1,410	1,523
Net claims on central government	-277	-364	-332	-217	-409	-306	-306	-306
Claims	33	45	91	98	87	81	81	81
Deposits	310	408	423	315	496	387	387	387
Claims on the private sector	2,607	2,613	2,599	2,619	2,741	2,996	3,099	3,212
Other items (net)	-21	-17	-16	15	-133	97	97	97
Capital and Reserves	2,017	2,479	2,704	2,846	3,038	3,210	3,387	3,579
Deposits	3,535	3,988	3,978	4,261	4,378	4,776	5,056	5,260
Depository corporations survey								
NFA of the banking system 1/	4,781	5,312	5,219	5,189	5,491	5,435	5,310	5,283
Central bank	4,580	4,949	5,039	4,894	5,235	5,176	5,051	5,024
Other depository corporations	201	364	179	295	256	259	259	259
NDA of the banking system	364	161	350	676	718	1,193	1,679	2,099
Net claims on central government	-1,137	-1,148	-948	-555	-536	-446	-446	-446
Claims on the private sector 2/	2,621	2,629	2,619	2,641	2,763	2,846	2,931	3,019
Other items (net)	-188	-192	-171	-188	-359	-150	-150	-150
Broad money (M3)	5,078	5,414	5,519	5,810	6,153	6,572	6,933	7,326
M1	3,843	4,329	4,421	4,741	5,139	5,488	5,790	6,118
Currency outside banks	828	1,025	1,170	1,188	1,322	1,412	1,489	1,574
Demand deposits	3,015	3,304	3,252	3,553	3,817	4,077	4,301	4,544
Savings and time deposits	1,234	1,085	1,098	1,068	1,015	1,084	1,143	1,208
	(In percent change)							
Reserve money	-7.1	23.0	10.6	4.0	9.6	6.0	5.5	5.7
Credit to the private sector	6.2	0.3	-0.4	0.8	4.6	3.0	3.0	3.0
Broad money	-3.1	6.6	1.9	5.3	5.9	6.8	5.5	5.7
Memorandum items:								
Money multiplier (level)	1.8	1.5	1.4	1.4	1.4	1.4	1.4	1.4
Loan-to-deposit ratio (in percent)	73.8	65.5	65.3	61.5	62.6	62.7	61.3	61.1
Interest rates (percent per annum)								
Deposit rate 3/	0.4	0.6	0.5	0.5	0.4	…	…	…
Lending rate 3/	10.3	10.3	10.1	9.6	8.7	…	…	…
NCG of financial corporations (in SI$ millions)	-954	-902	-625	-198	18	136	136	136
91-day treasury bill rate (percent per annum)	0.5	0.5	0.5	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, 2016–2024H1

	2016	2017	2018	2019	2020	2021	2022	2023	1H 2024
	(In percent, unless otherwise indicated)								
Capital Adequacy									
Regulatory Capital to Risk-Weighted Assets	32.5	35.0	31.1	31.3	32.6	31.7	31.8	33.6	36.7
Non-performing Loans Net of Provisions to Capital	8.1	14.3	15.8	23.5	21.6	18.2	15.7	14.7	13.8*
Asset Quality									
Non-performing Loans to Total Gross Loans	3.8	6.4	7.1	10.4	10.7	10.4	9.5	9.4	10.6
Provisions to Non-performing Loans	31.2	18.7	30.9	29.4	30.1	36.8	40.0	40.7	43.3
Earnings and Profitability									
Return on Assets	3.5	3.9	3.5	3.1	2.1	2.3	5.9	6.5	2.6
Return on Equity	16.6	16.2	14.2	13.3	8.9	9.8	26.4	27.4	14.4
Interest Margin to Gross Income	56.3	55.0	54.3	53.3	58.7	58.1	55.1	55.0	50.3*
Non-interest Expenses to Gross Income	47.1	47.4	51.8	53.7	56.2	55.6	56.3	52.0	58.0*
Liquidity									
Liquid Assets to Total Assets (Liquid Asset Ratio)	38.1	38.4	40.6	37.4	45.7	46.8	48.1	48.0	49.7*
Liquid Assets to Short Term Liabilities	53.3	55.4	56.3	56.3	64.7	65.8	68.8	66.0	67.2
Net open position in foreign exchange to capital	4.5	4.5	5.4	2.7	3.1	3.9	3.9	3.5	5.9

Sources: IMF and CBSI

Note: * refers to Q1 2024 data

Annex I. Risk Assessment Matrix[1]

Sources of Risks	Likelihood	Expected impacts	Recommended Policy Responses
External Risks			
Commodity price volatility. Supply and demand fluctuations (e.g., due to conflicts, export restrictions, OPEC+ decisions, and green transition) cause recurrent commodity price volatility, external and fiscal pressures and food insecurity in EMDEs, cross-border spillovers, and social and economic instability.	High	**Medium.** Solomon Islands is sensitive to increases in global prices and supply chain disruptions as it is heavily dependent on imports. Sharp commodity price rises could generate inflation and/or significant cost-of-living pressures.	• Reprioritize fiscal policy to ramp up targeted support for those vulnerable and slow down lower priority expenditure. • Efforts to diversify the economy, enhance domestic agriculture productivity, and increase the use of renewable energy should be continued.
Deepening geoeconomic fragmentation. Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions, protectionism, policy uncertainty, technological and payments systems fragmentation, rising shipping and input costs, financial instability, a fracturing of international monetary system, and lower growth.	High	**Medium.** Higher import prices due to supply disruptions and/or rising shipping and input costs could push up inflation and affect fiscal and external sustainability.	
Global growth surprises: Slowdown. Growth slowdown in major economies, including due to supply disruptions, tight monetary policy, rising corporate bankruptcies, or a deeper-than-envisaged real estate sector contraction, with adverse spillovers through trade and financial channels, triggering sudden stops in some EMDEs.	Medium	**Medium.** Global Economic slowdown particularly in main trading partners like Australia or China could negatively affect the growth prospect in Solomon Islands, particularly via the commodity export channel.	• Provide targeted fiscal support as needed to most-affected groups, while carefully watching inflation developments and public debt sustainability. • Seek additional donor support.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). 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. The conjunctural shocks and scenarios highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Sources of Risks	Likelihood	Expected impacts	Recommended Policy Responses
Domestic Risks			
Mismanagement of fiscal policy. A cash crunch triggered by lower-than-expected donor support or an unsuccessful bond issue in the shallow domestic market, coupled with weak PFM capacity, forces the government to cut spending without proper planning and to delay payments to suppliers.	**High**	**Medium.** Government activity accounts for a substantial share of output in Solomon Islands. Under-execution of the budget would adversely affect economic activity, while delays in government payments to suppliers could pose a risk to financial stability.	• Strengthen basic PFM functions such as budget planning, as well as cash management and forecasting. • Enhance coordination with donors through steady implementation of reforms committed in budget support. • Enhance fiscal transparency and dialogue with potential investors to develop the domestic market.
Climate change. Extreme climate events driven by rising temperatures cause loss of life, damage to infrastructure, food insecurity, supply disruptions, lower growth, and financial instability. A disorderly transition to net-zero emissions and regulatory uncertainty lead to stranded assets and low investment.	**Medium**	**High.** Solomon Islands faces high natural disaster risk, with limited capacity to address the risk. Adverse climate events would have significant impacts on vulnerable areas/populations with knock-on effect on aggregate growth.	• Invest in resilient infrastructure to promote climate change adaptation. • Enhance fiscal buffers to meet climate financing needs, including through exploring donor support.
Social discontent. High inflation, real income loss, spillovers from conflicts (including migration), and worsening inequality stir social unrest, drive populist policies, and increase resistance to reforms, especially in the context of polarized or disputed elections. This exacerbates imbalances and weakens growth prospects, leading to policy uncertainty and market repricing.	**Medium**	**High.** Solomon Islands has a history of social unrest and political instability. Should the risk materialize in the form of civil unrest, it could significantly damage capital and hamper economic activity.	• Explore inclusive growth through improving the delivery of public services and providing well-targeted support to the vulnerable. • Take measures to improve governance, policy transparency, job creation, and quality of public services.

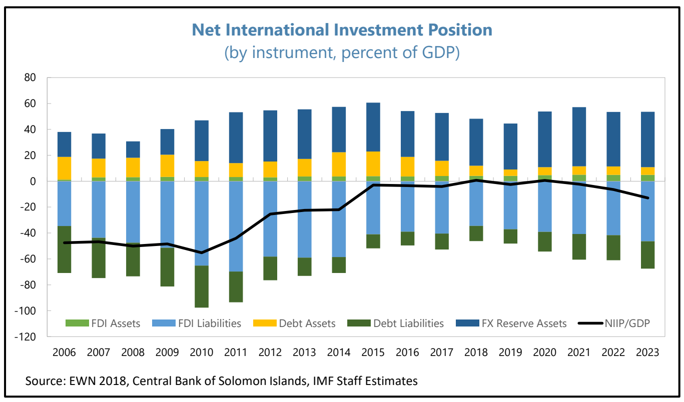
Annex II. External Sector Assessment[1]

Overall Assessment: *The external position of Solomon Islands in 2023 was weaker than the level implied by fundamentals and desirable policies. Staff assess that the current account deficit (at 10.4 percent of GDP), after adjusting for cyclical and natural disasters, was around 3.9 percent of GDP below the estimated norm, corresponding to a real effective exchange rate overvaluation in the range of between 12-15 percent. The external position is expected to remain stable, with reserve coverage declining over time but remaining at an adequate level.*

Potential Policy Responses: *Structural policies, particularly those improving competitiveness and export diversification, combined with prudent fiscal policies, can help reduce the current account deficit over the medium term. A financing mix primarily involving grants and highly concessional loans would help contain financing costs and avert debt accumulation. The currency basket should be regularly updated to reflect the country's trade structure.*

Foreign Assets and Liabilities: Position and Trajectory

Background. The deficit in Solomon Islands' net international investment position (NIIP) has widened to -13.2 percent of GDP in 2023, from a small surplus of around 0.7 percent in 2018. This deterioration has been primarily driven by an increase in foreign direct investment (FDI) liabilities, centered around infrastructure investment, while debt liabilities have also significantly increased in recent years. Reserve assets have remained steady at around 43 percent of GDP, equivalent to 78 percent of gross assets. On the liabilities side, FDI liabilities have grown to nearly 47 percent of GDP, equivalent to around 69 percent of total liabilities. Debt liabilities have increased to around 21 percent of GDP, nearly doubling over the past five years.



Assessment. The NIIP is expected to remain broadly stable in the medium-term, as reserves would remain relatively strong, supported by continued aid inflows. While debt liabilities account for 31 percent of total liabilities, they are mostly on concessional terms with multilateral creditors. Given the relatively large share of FDI liabilities compared to portfolio liabilities, the structure of the external balance sheet entails relatively contained vulnerabilities.

2023 (% GDP)	NIIP: -13.2	Gross Assets: 55.2	Debt Assets: 6.0	Gross Liabilities.: 68.4	Debt Liabilities.: 21.5

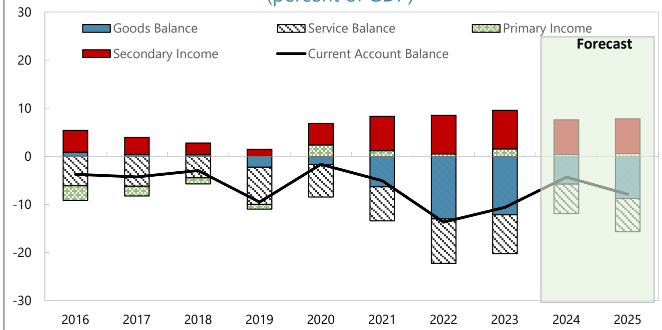
[1] Prepared by Narayan Suryakumar (APD)

Current Account

Background. The current account (CA) deficit stood at 10.4 percent of GDP in 2023, down from 13.7 percent of GDP in 2022. The deficit remained wide primarily reflecting the increased imports related to infrastructure development leading up to the Pacific Games. In 2024, the CA deficit is expected to narrow, supported by normalizing of imports related to infrastructure development.

Assessment. The EBA-lite CA model indicates a negative gap of 3.9 percent of GDP, reflecting an adjusted CA balance of -10.2 percent and an adjusted CA norm of -6.2 percent. The CA is assessed to be weaker than that consistent with medium-term fundamentals and desirable policy settings. The adjusted CA of -10.2 percent accounts for the effects of natural disasters (0.1 percent of GDP) and cyclical factors (0.1 percent of GDP). The CA gap of 3.9 percent of GDP is consistent with a REER overvaluation of around 15 percent.

Current Account Balances
(percent of GDP)



Source: CBSI, IMF Staff estimates

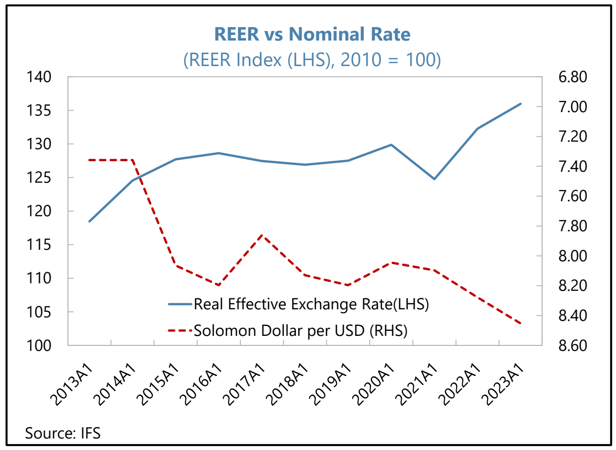
Table 1. Solomon Islands: EBA-lite Model Results, 2023

	CA model 1/	**REER model** 1/
	(in percent of GDP)	
CA-Actual	**-10.4**	
Cyclical contributions (from model) (-)	-0.1	
Natural disasters and conflicts (-)	-0.1	
Adjusted CA	**-10.2**	
CA Norm (from model) 2/	**-6.2**	
Adjusted CA Norm	**-6.2**	
CA Gap	**-3.9**	**-3.3**
o/w Relative policy gap	4.2	
Elasticity	-0.3	
REER Gap (in percent)	**14.5**	**12.1**

1/ Based on the EBA-lite 3.0 methodology

2/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

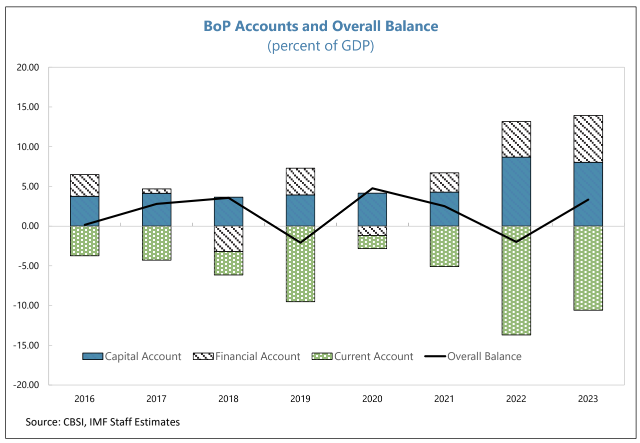


Source: IFS

Background. The real effective exchange rate is estimated to have appreciated by nearly 3.0 percent in 2023, continuing a long-run appreciation trend. Meanwhile, the terms of trade are estimated to have declined in 2023, as prices of export commodities (logs, minerals and fish) fell more than the drop in prices of import goods (food, fuel).

Assessment. Similar to the CA model approach, which suggests a real exchange rate overvaluation of 15 percent, the REER approach indicates that the real exchange rate was overvalued by 12.1 percent in 2023. This is consistent with the recent developments on inflation in Solomon Islands and its main trading partners. While this result does not automatically imply a need for nominal exchange rate adjustment, it highlights the need to review the currency basket to ensure that the currency composition and weights of the basket appropriately reflect the country's current trade structure. 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: Flows and Policy Measures



Source: CBSI, IMF Staff Estimates

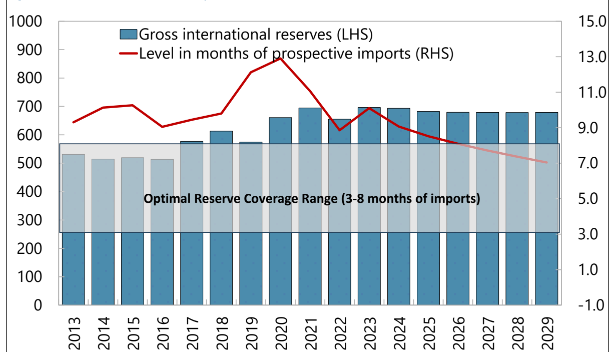
Background. The capital and financial accounts have helped finance the widening CA deficit and build up foreign exchange reserves in recent years. Donor support such as project grants and concessional borrowing has been a key source of external financing, while FDI investment has also risen.

Assessment. Capital and financial accounts are expected to remain stable over the medium term, supported by continued donor support and FDI inflows.

FX Intervention and Reserves Level

Background. Gross official reserves increased to US$682 million in 2023, supported by donor support leading up to the Pacific Games, gold exports, and tourism. This level of reserves translates to around 10 months of prospective imports. Strong official reserves have helped preserve macroeconomic stability and maintain the fixed exchange rate regime. However, since the local currency is used as numeraire for reserves management, the central bank has had to periodically intervene against the target (USD/SBD) rate to stabilize its foreign reserve revaluation account[1]. These interventions have caused significant deviations in the past between the announced and calculated basket spot prices.

Official Foreign Exchange Reserves
(In millions of US dollars)



Sources: Authorities data; and IMF staff calculations and projections.

Assessment. The level of reserves is expected to remain within the adequacy range of three to eight months of imports over the medium term (Table 1). Exports diversification and reducing reliance on the mining and logging sectors will help narrow the CA deficit over the medium term and slow the decline in reserves. Updating the weights in the currency basket and improving transparency of FX operations can help prevent exchange rate misalignments and better align with the primary objective of price stability.

Table 2. Solomon Islands: Optimal Range of Reserve Adequacy Ratios

	Reserves / Months of imports		
Prob of shock	Resource rich	Small State	Fragile
65%	6.7	3.2	2.9
70%	7.3	3.5	3.2
75%	7.8	3.7	3.4

Note: Given that Solomon Islands is a fragile, resource-rich, small developing state (SDS), the ARA metric for the country falls within a wide band encompassing these three categories. The range of reserve adequacy ratios above is based on an estimate for marginal cost of holding reserves of 5.57 percent (see 2013 IMF paper on ARA – Further Considerations). The selected range of the probabilities of a large climate/natural disaster shock is based on the 2018 IMF paper on the Economic Impact of Natural Disasters on the Pacific Island Countries.

[1] FX reserves are reported in Solomon dollars and their revaluation impacts the CBSI capital position.

Annex III. Maximizing the Positive Impacts of Emigration from Solomon Islands[1]

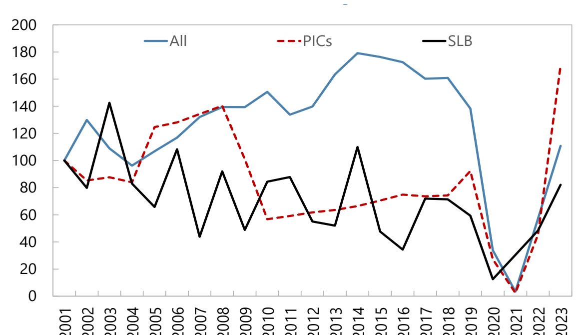
Solomon Islands is experiencing an uptick in emigration, generating a mix of economic opportunities and challenges. This annex explores the underlying causes and effects of emigration. First, it highlights how the economic conditions in destination countries (i.e., Australia and New Zealand) drive emigration. Second, it shows that while remittances from emigrants elevate household incomes and spur short-term GDP per capita growth, these effects are ephemeral. Third, it presents several focuses for policy measures that Solomon Islands can leverage to boost emigration's impact on economic growth.

A. Increasing Emigration from Solomon Islands

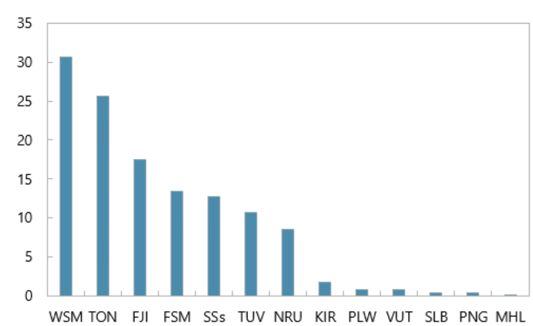
1. Emigration from Solomon Islands has increased rapidly after the pandemic.[2] Solomon Islands has fewer emigrants compared to other Pacific Island Countries (PICs), as shown in Figure 1. Nonetheless, the rate of long-term emigration to New Zealand and Australia is rising faster than in other PICs. The United Nations projects that net emigration from Solomon Islands will be 4.5 percent higher in 2032 than in 2022, which will reduce the working-age population by 3.8 percent in 2032 and by 5 percent in 2042 relative to a scenario without migration.[3] Understanding emigration drivers and their impact is, hence, imperative to guide economic policy.

Figure 1. Emigration to Australia and New Zealand and Migrants Stock

Emigration to Australia and New Zealand
(Index = 2003; net emigration)



Migrants Stock as Share of Population
(In percent)



Source: Cagilaba, Merga, Zhang (forthcoming).

[1] Prepared by Roman Merga (RES). The author is greatly indebted with Smets Lodewijk, Nakamura Shohei, and Ryoko Sato of the World Bank for help processing and making available the Census 2019 data.

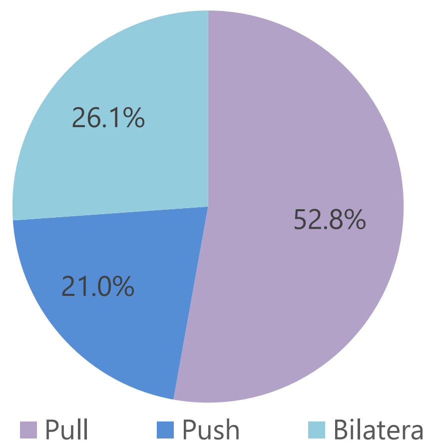
[2] Emigrants are defined for the purpose of this annex as long term emigrants, which account for emigrants staying at least 6 months in the receiving country.

[3] The data for UN estimates are available here.

B. Determinants, Opportunities, and Risks of Increased Emigration for Solomon Islands

2. The performance of destination countries is the main driver of emigration from PICs. Emigration is determined by three main components. The first component, pull factors, refers to the characteristics in the destination country, common to all origins, that "pulled" workers into that country. The second factor, push factors, refers to the origin country's characteristics that incentivize people to emigrate, regardless of the destination. The third component is bilateral components, in which characteristics specific to the origin-destination pair of countries generate incentives for emigration. Factor analysis indicates that pull factors have been the drivers of emigration from PICs, unlike other small states: more than half of the observed emigration flows from PICs between 2005 and 2019 were driven by characteristics of the destination countries, potentially due to recent labor shortages and higher wages growth in destination countries (Figure 2, Cagilaba, Merga, and Zhang, forthcoming).

Figure 2. Drivers of Emigration from Pacific Island Countries



Source: Cagilaba, Merga, Zhang (forthcoming).

3. Emigration can be an opportunity to provide jobs for rapidly growing young population. As emigration is mostly driven by global demand for workers, Solomon Islands could see a quick rise in emigrants, given its small population and the low share of emigrants per population.

4. As global trends influence emigration demand, Solomon Islands is not entirely free from associated risks. Relying on emigration as a strategy to manage a quickly growing workforce makes the country vulnerable to international shifts in emigration patterns. In addition, since pull factors predominantly drive emigration, increased emigration could adversely affect the economy, as emigration of skilled workers depletes the country's human capital or if emigrants encounter challenges in contributing to the local economy upon their return.

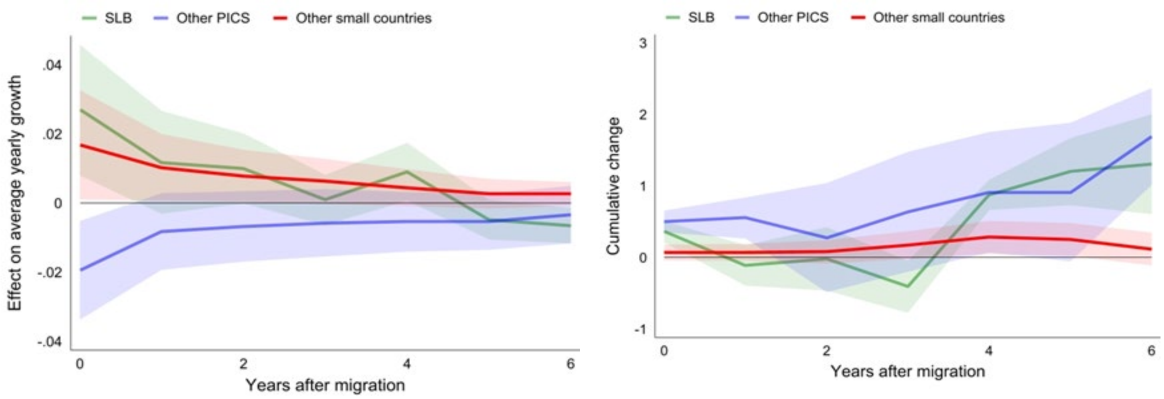
C. Net Emigration Effect on Solomon Islands—Not Usual PICs Effects

5. **For Solomon Islands, unlike other PICs, net emigration boosts GDP per capita growth, though the benefits appear temporary.** As shown in Panel A of Figure 3, a 1 percent rise in net emigration is associated with a 0.01 percentage point increase in the average annual growth rate of GDP per capita for after two years, but this effect fades by the third year.[4] While the estimated impact is small, this is in stark contrast to the negative impact observed in other PICs and the enduring positive effects in other small developing nations. Therefore, Solomon Islands faces a dual challenge: firstly, to elevate net emigration levels to benefit from its initial positive impact on GDP per capita; and secondly, to make these fleeting benefits more persistent.

Figure 3. Economic Impacts of Emigration

GDP per capita Yearly Growth Response to Emigration
(Response to 1 percent increase in net emigration over population)

Remittances per capita Response to Emigration
(Response to 1 percent increase in net emigration over population)



Source: IMF staff estimates

6. **Remittances per capita to Solomon Islands significantly rise following net emigration, as illustrated by Panel B of Figure 3.** Initially, there's little reaction in remittances three years after emigration, possibly due to the upfront costs associated with long-term relocation and influenced by the wage trends among emigrants. However, beyond the initial three years, remittances per capita see an approximate 1.5 percent boost for every 1 percent increase in net emigration.[5]

[4] This annex adopts the instrumental variable (IV) approach of Seruwaia, Merga, and Zhang (2024) to analyze the impacts of emigration on PICs and other small nations. It modifies the dependent variable to reflect the cumulative changes in average yearly growth. Due to the insufficiency of the instrumental variable's strength for Solomon Islands, the analysis for this specific case employs standard Ordinary Least Squares (OLS) regression for this country and the IV for the rest of countries.

[5] Considering the prevalent issues with underreporting due to informal remittance channels, the actual impact of net emigration on remittances is likely more substantial than reported.

D. Remittances and Households in Solomon Islands

7. The 2019 Census reveals a positive link between education attainment and remittances.[6] Households that receive remittances are, on average, 3 to 5 percent more likely to have an English-proficient member, 4 percent more likely to include someone with education from 3rd to 7th grade, and 7 percent more likely to have at least one member educated beyond the 7th grade, as detailed in Table 1. Notably, these associations seem consistent across different remittance levels, indicating that the educational benefits are not limited to households enjoying high remittance incomes. These findings suggest that remittance flows can enhance family members' access to education by providing additional resources and more incentives to acquire education, as supported by existing literature (Gibson and others, 2011; Chand and others, 2008).

Table 1. Solomon Islands: Probability of Getting Remittances Depending on Education

Household characteristics	Receive remittances	Receive high remittances
High proficiency in English	5.3 percent	3.1 percent
Education between form 3 and 7	4.0 percent	4.2 percent
Education above form 7	7 percent	7 percent

Source: IMF staff calculation based on Solomon Islands 2019 Census Data.
Note: High remittances correspond to remittances above SI$1,500 a year. Results follow after estimating a linear probability model controlling for household characteristics, such as their province, number of people in the household, share of females, and ethnicity.

8. Higher remittances allow households to engage in more non-subsistence private activities. Specifically, households receiving remittances are 2.1 percent more likely to utilize their land for commercial purposes, such as selling farm products, operating a canteen, or providing various services (Table 2). Additionally, these households show a 4.5 percent higher likelihood of owning at least one financial account. There's also a notable 1.2 percent decrease in labor market participation among women in these households, indicating significant income effects that benefit this group. This pattern aligns with findings from other regions, where remittances have been shown to mitigate challenges associated with low financial development (Ambrosius and others, 2013) and contribute to financial sector growth (Aggarwal and others, 2011). The increase in disposable income, coupled with the countercyclical nature of remittances, may motivate recipients to invest in potentially riskier, yet more rewarding, private ventures in the long run.

[6] We thank the World Bank for assistance in processing the 2019 Census data.

Table 2. Solomon Islands: Differential Probability of Getting Remittances Depending on Education

	Probability of having financial account	Probability of alternative land uses	Probability of female active in labor market
Households receiving remittances	4.5 percent	2.1 percent	-1.2 percent

Source: IMF staff calculation based on Solomon Islands 2019 Census Data processed by the World Bank.
Note: High remittances correspond to remittances above SI$1,500 a year. Controls include household's province, number of

E. Boosting Opportunities while Mitigating Emigration Risks

9. Achieving stable and comprehensive relationships with foreign destinations and extending agreements beyond labor mobility to include trade and capital flows can mitigate the risks associated with excessive reliance on emigration. Establishing deeper and more stable bilateral or multilateral agreements can protect against fluctuations in emigration caused by external political and economic conditions. Moreover, agreements that encompass labor mobility, international trade, and capital movements will stimulate economic activities, thereby diminishing the dependency on emigration to relieve labor market pressures from rapid population growth.

10. Furthermore, reducing the costs associated with sending remittances could significantly boost remittance flows to Solomon Islands. In 2011, the cost for emigrants sending remittances to Solomon Islands was estimated to be 40 to 60 percent higher than in other PICs like Fiji, Kiribati, Tonga, and Tuvalu.[7] This suggests that the remittance inflow per emigrant could be substantially higher than currently observed if these costs were lowered to levels seen in other PICs, by encouraging the entry of money transfer agents or utilizing digital financial services. Such a reduction can yield multiple benefits: it would increase disposable income for households receiving remittances, encourage the use of formal remittance channels promoting integration into the formal financial sector, and enhance the role of remittances as a timely and faster source of support during adverse household shocks, improving its countercyclical and insurance-like properties.

11. The small size of Solomon Islands' private sector limits its ability to enjoy the full benefits of emigration on GDP growth. While emigration increases remittances and incomes for those remaining, it could also bring other advantages like introducing new products or ways of producing (Fackler and others, 2020), boosting exports (Bastos and others, 2012), and easing the financial hurdles for starting businesses. However, these advantages require a supportive environment that promotes such growth. High costs due to inefficient bureaucracy or poor infrastructure make it hard for businesses to grow or start, preventing them from using the new

[7] The data is based on Remittance Prices Worldwide from World Bank.

knowledge or opportunities that emigration might bring in. Therefore, improving the business environment, easing the process of starting a business, and making it easier to get credit and trade can help the private sector benefit more from emigration.

12. Low levels of human capital development in Solomon Islands may also be limiting the potential gains from emigration. Emigration heightens incentives for higher education by making it more rewarding (Gibson and others, 2011; Chand and others, 2008) and by increasing household income, which can make education more accessible. However, if education quality is poor or access to it is prohibitively expensive, it is unlikely that emigration will lead to higher educational achievements. As emigration continues to grow, fine-tuning emigration policies to minimize human capital loss while also enhancing access to education becomes crucial. Similarly, encouraging and facilitating the return of emigrants, particularly those with significant skills and knowledge, is essential.

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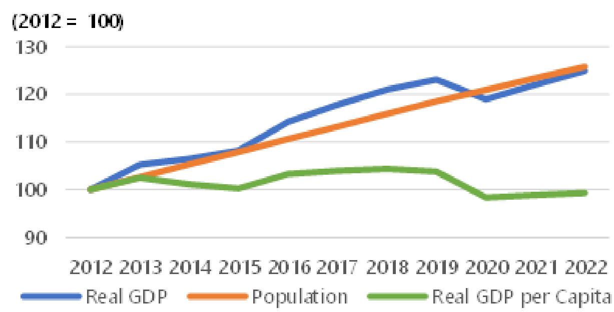
Annex IV. Enhancing Growth in Solomon Islands through Digital Financial Inclusion[1]

Solomon Islands has continued to face low levels of growth and limited financial inclusion over the past decade. Using a composite index that accounts for digital financial inclusion, staff estimates find that improving the level of financial inclusion can help to increase growth and per capita income in the country. Policy measures that reduce barriers to financial inclusion, such as strengthening digital financial literacy and consumer protection, would help support growth.

1. **Solomon Islanders have not seen their per capita income rise in real terms for a decade.** Real GDP growth for the past decade falls short of population growth, leading to lower income per capita compared to a decade ago. It has been widely documented that financial inclusion can help enhance growth in developing economies (Barajas and others 2020; Khera and others 2021; Loukoianova and others 2018). For small island developing economies like Solomon Islands, where the population is widely dispersed across many geographically remote islands, digital technologies can promote greater financial inclusion and help improve economic growth.

Figure 1. Real GDP and Population



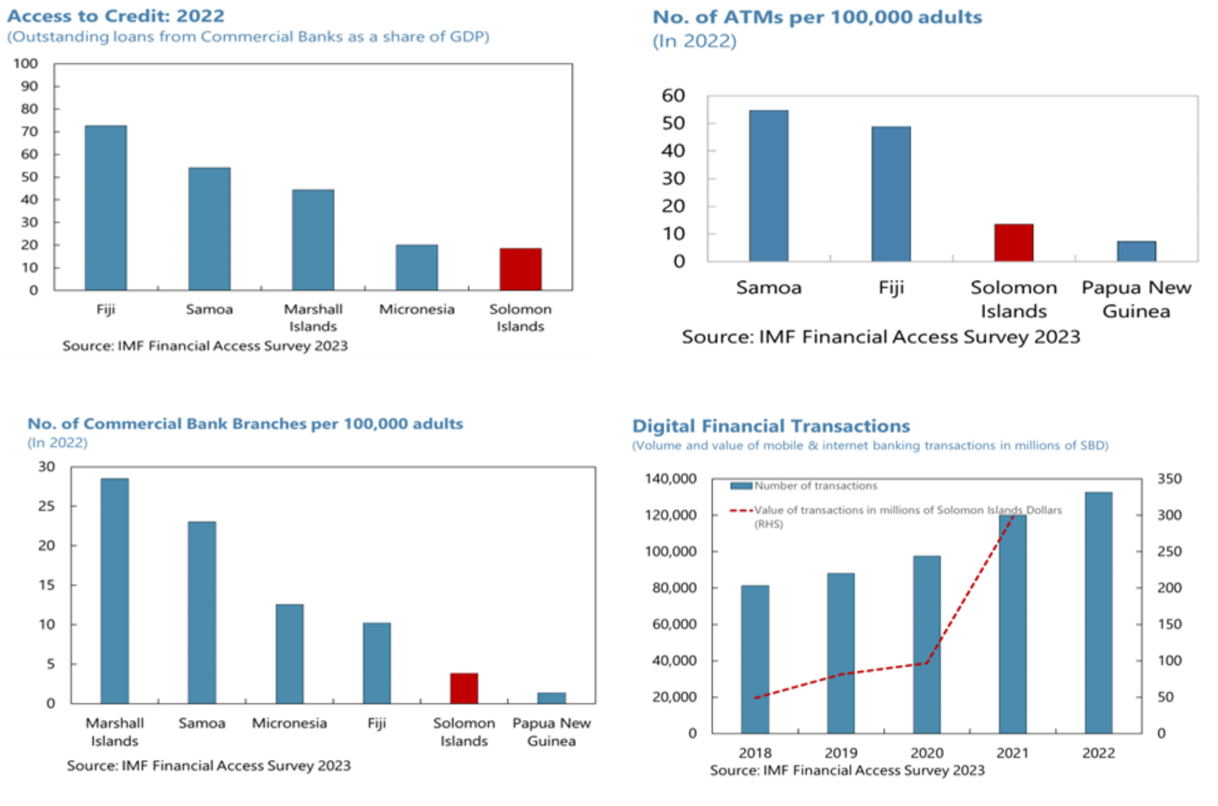
Source: Solomon Islands National Statistics Office and IMF staff estimates.

2. **Financial inclusion in Solomon Islands remains limited.** The 2019 Census showed that only 30.0 percent of the total population in Solomon Islands have at least one account in a financial institution, of which 35.0 percent are within the banking sector, followed by the superannuation sector. The state of financial inclusion in Solomon Islands is also far behind similar economies in the Pacific region (Figure 2). Access to formal banking services such as commercial bank branches and ATMs in Solomon Islands remains well below other Pacific Islands countries (IMF Financial Access Survey 2023). Financial sector depth as measured by commercial banks outstanding loans as a share of GDP is also lower than those of other Pacific Island countries like Fiji, Samoa, and Marshall Islands. However, there are signs of increasing use of digital financial services in Solomon Islands. Both the volume and value of mobile and internet banking transactions in Solomon Islands have risen steadily since 2018 (IMF Financial Access Survey 2023). This trend is likely to continue following the recent introduction of M-Selen[2] in June 2023 that should improve access to mobile money services in rural areas

[1] Prepared by Seruwaia Cagilaba, a former staff member in the IMF Regional Resident Representative Office in Fiji.

[2] M-Selen is a mobile money service offered by telecommunication service provider Our Telekom that allows customers to send and receive money through their mobile phones.

Figure 2. Access to Formal Banking Services in Solomon Islands



3. **Gender gaps in financial inclusion are prevalent.** According to the 2019 Census, a greater share of the financially excluded were female.[3] Gender disparities are prevalent, with disproportionately higher number of males having access to formal financial services than females, irrespective of age, education level, income, and employment status (Table 1). Even among rural and urban dwellers, a higher number of males have access to formal financial services than females. Interestingly, gender gaps remained wide regardless of access to financial literacy training or distance to the nearest access point.

[3] 53.0 percent of those excluded from the financial sector are female which is equivalent to 76.0 percent of the total female population.

Table 1. Solomon Islands: Key Determinants of Financial Inclusion in Solomon Islands

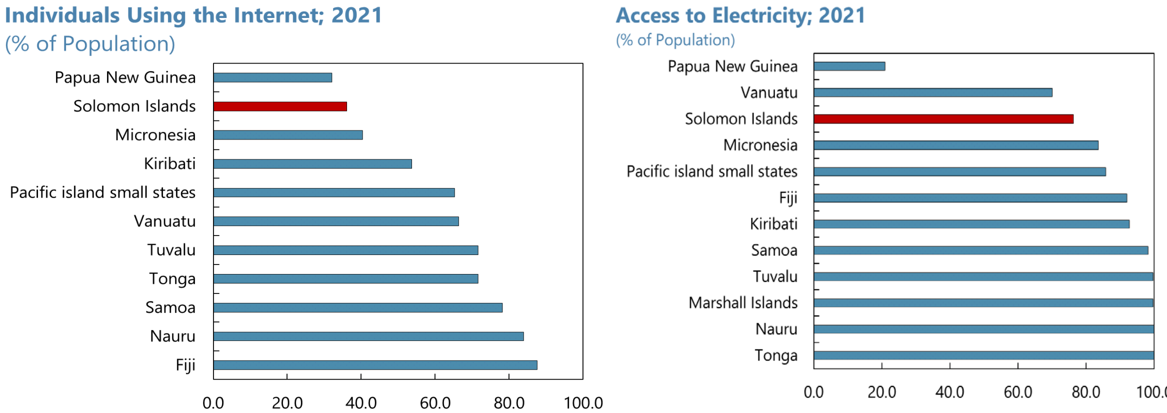
Key Determinants of Financial Inclusion		% of Population *with at least 1* account in financial institutions		% of Population *without any* account in financial institutions	
		Male	Female	Male	Female
Age	0-14	0.1	0.1	5.0	4.7
	15-24	2.4	2.0	11.8	11.9
	25-44	10.1	6.8	9.4	12.0
	45-64	4.8	2.5	4.6	6.2
	65-	0.7	0.3	2.1	2.5
	Total Population	**18.1**	**11.8**	**32.8**	**37.3**
Place of residence	Urban	8.5	6.2	6.8	8.3
	Rural	9.7	5.6	26.0	29.0
Education level completed	No school completed	1.0	0.9	4.9	7.6
	Primary education	6.0	3.8	18.1	19.8
	Secondary education	6.7	4.4	8.4	8.8
	Tertiary education	3.7	2.5	0.9	0.7
	Vocational / professional qualifications	0.7	0.2	0.6	0.3
Employment status	Employed	15.8	9.2	11.7	22.9
	Unemployed	2.3	2.5	21.2	14.4
Nearest financial access point	*The nearest answer of each person:*				
	Less than 30 min.	11.4	7.8	17.0	19.4
	30 min.-1 hr.	2.9	1.8	4.8	5.5
	1-2 hr.	1.6	0.9	3.5	3.9
	2-3 hr.	0.6	0.4	1.8	1.9
	3 hr. or longer	1.6	0.8	5.8	6.5
Financial literacy training	Yes	3.2	2.5	1.7	2.0
	No	14.9	9.3	31.1	35.3
Main source of income	No income	0.2	0.1	1.3	1.4
	Wages/Salary	9.0	6.2	6.6	8.8
	Remittances	0.2	0.2	0.6	0.8
	Others	8.3	5.4	24.3	26.5

Source: Solomon Islands 2019 Population Census

4. **Several factors may have contributed to limited financial inclusion in Solomon Islands.** On the supply side, geographical terrain is a key obstacle in Solomon Islands that is made up of a number of remote islands,[4] making it very difficult and costly to enable universal access to traditional financial access points. Most financial services providers are concentrated around the capital city Honiara, limiting financial access to the rural population. As a result, nearly 78.0 percent of rural dwellers did not own an account in a financial institution in 2019. Infrastructure gaps can also be a barrier to financial inclusion, because it raises the costs of doing business and limits the wider adoption of digital financial services. Access to the Internet and electricity in Solomon Islands is among the lowest in the Pacific Islands region (Figure 3). According to the 2019 Census, only 15.3 percent of the population were connected to the electricity grid (of which 62 percent were in Honiara), and less than 50 percent have access to the Internet and mobile phones.

[4] Solomon Islands comprises 992 islands of which 147 are inhabited. See: https://solomons.gov.sb/about-solomon-islands/.

Figure 3. Key Infrastructure Gaps in Solomon Islands



Source: World Development Indicators

Source: World Development Indicators

5. **Demand side factors also act as barriers to financial access in Solomon Islands.** On the demand side, the lack of proper identification requirements has prevented access to financial services, while the absence of reliable income sources and high transaction costs have discouraged the use of financial services. In the 2019 Census, nearly 80 percent of those without an account in financial institutions did not earn a regular income from wages and salaries or remittances. Complicated land management and the lack of available movable collateral can also restrict access to credit. Poor financial literacy, including digital financial literacy, is another barrier to financial inclusion. Almost 95.0 percent of those without an account with financial institutions had not received any financial literacy training (2019 Census). A recent study found that digital financial literacy in Solomon Islands is significantly lower among women, particularly rural women, and adults with lower levels of education and income (UNCDF 2023). Another study in 2016 (Pacific Financial Inclusion Programme) found low levels of financial literacy among rural adults, particularly women.

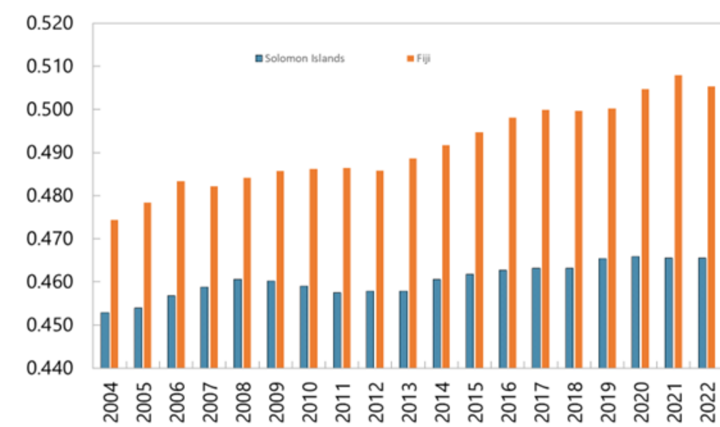
6. **Studies suggest that greater financial inclusion including through digitization can boost growth.** There have been several studies on the financial inclusion – growth nexus that is broadly applicable to Solomon Islands. Levine (2005) and Popov (2018) showed a positive and significant relationship between financial depth measures and long-run economic growth. Sahay and others (2015) found that financial inclusion does have a significant impact on growth and that the impact on growth increases with the level of financial inclusion. Loukoianova and others (2018) concluded that there are potentially considerable growth benefits from financial inclusion, with the largest gains for low-income and developing countries. In the same study, it was estimated that increasing the level of financial inclusion from the bottom quartile (that included Solomon Islands) to the median (Malaysia) could lead to an increase of 0.2 percent in per capita income growth over a five-year period. The study also found that leapfrogging led to improved access to traditional banking services in the Pacific Island countries with broader access to technology leading to greater financial inclusion. Notably, little literature has examined the link between digital financial inclusion and growth. McKinsey (2016) predicted that digital finance (including mobile money and mobile banking) could increase GDP of emerging economies by 6 percent by 2025. Khera and others (2021)

concluded that digital financial inclusion has a positive impact on economic growth and that improving digital financial inclusion in payments is found to increase annual economic growth by up to 2.2 percentage points.

7. A composite index indicates that financial inclusion in Solomon Islands has not made much progress since 2019. Compiling a composite index helps overcome the drawbacks of using only a single indicator to measure financial inclusion. Following Nizam and others (2020) and Sarma (2012), staff developed a composite index of various financial indicators to measure financial inclusion in Solomon Islands from 2004-2022 (Figure 4). This composite index applies equal weights to four key dimensions of financial inclusion: availability of financial services, penetration of banking services, use of traditional financial services, and use of digital financial services. As such, the index enables staff to account for financial inclusion that arises from the use of digital financial services. The compiled index indicates that financial inclusion in Solomon Islands has not made much progress since 2019, while Fiji has made some improvement.

Figure 4. Financial Inclusion Index (IFI Index) 2004-2022

Scale 0 – 1 with 1 being complete financial inclusion



Source: IMF Staff Calculations

8. Staff estimates imply that improvements to financial inclusion can support growth and income in Solomon Islands. To assess the impact of financial inclusion in Solomon Islands, staff ran regressions using the composite index of financial inclusion as an independent variable and growth measures (i.e., logs of nominal GDP, real GDP, and GDP per capita) as a dependent variable. Control variables include log of population growth, log of government spending as a share of GDP, log of financial depth[5] and openness[6], and a measure of governance in logs[7]. While the small sample size requires caution in interpreting the outcome, it shows a positive relationship between GDP and financial inclusion: a 1 percent improvement in the level of financial inclusion could increase output in Solomon Islands by 8 to 16 percent (Table 2). Financial inclusion is also found to have a positive impact on the per capita income level, which suggests that improving financial inclusion can help to

[5] Financial depth is measured using data on domestic credit to private sector (percent of GDP) from World Development Indicators.

[6] Financial openness is measured using data from World Development Indicators on net inflows of foreign direct investment (percent of GDP).

[7] Governance is measured using data sourced from Worldwide governance indicators 2023 Update on estimates of political stability and absence of violence/terrorism and estimates of control of corruption.

reduce poverty in Solomon Islands. Staff estimates also found governance to be a key determinant of growth in Solomon Islands.

Table 2. Solomon Islands: Financial Inclusion – Growth Nexus in Solomon Islands 2012-2022

Dependent Variable:	log Nominal GDP	log Real GDP	log GDP per capita
Impact of Financial Inclusion			
log of Index of Financial Inclusion (IFI)	16.99 (2.74)***	8.06 (0.82)***	7.93 (2.10)***
Control variables			
log of financial depth	0.16 (0.14)	0.17 (0.06)**	0.01 (0.09)
log of government spending	-0.96 (0.39)*	-0.44 (0.18)*	-0.49 (0.29)
log of population growth	1.09 (0.75)	0.13 (0.16)	1.43 (0.46)**
log of financial openness	-0.03 (0.02)	0.01 (0.01)	-0.04 (0.02)**
log of governance	-0.40 (0.15)**	-0.32 (0.07)***	-0.14 (0.10)
Memorundum items:			
Number of observations	13	13	13
R^2	0.943	0.943	0.861

Source: the author's estimates.
Note: The estimates are based on the Generalised Method of Moments. Standard erros are reported in parentheses. *, **, and *** denote the statistical significance of 10 percent, 5 percent, and 1 percent, respectively.

9. Policy reforms are needed to improve financial inclusion and support economic growth. Staff estimates suggest that financial inclusion can be a key driver of growth in Solomon Islands. The authorities should continue reforms that support financial inclusion and growth, with assistance from development partners. Digital technologies can be a key enabler of financial inclusion in Solomon Islands, given its geographical terrain and widely dispersed islands. The enactment of the National Payments Systems Act in 2022 should help support the development of accessible and affordable digital financial services. Key infrastructure gaps constraining access to and use of digital financial services need to be addressed, including by improving access to electricity and the internet. Moreover, the authorities may consider developing a national ID system to help support KYC initiatives and improve access to financial services. The authorities should continue with financial literacy initiatives, focusing on enhancing digital financial literacy, particularly among women, adults living in rural areas, and those with low levels of education and income. To encourage trust in the digital financial system, the authorities should strengthen consumer protection frameworks and data privacy laws. To support informed policy decision making, the authorities should strengthen collection of more granular data on financial inclusion initiatives (e.g., data on volume and value of digital payments broken down by different payment channels, gender, and others). Policymakers need to balance policy priorities, especially between financial integrity (AML/CFT) concerns and financial inclusion goals, so that policies designed to safeguard financial stability risks are implemented to ensure financial inclusion, including through the application of risk-based AML/CFT measures. Finally, the authorities would benefit from developing policies to help address gender gaps in financial inclusion.

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Annex V. TA Priorities for FY25

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 and the income tax.
Banking Supervision and Regulation	Financial Sector Supervision	Develop/strengthen banking regulations and supervision frameworks	TA will assist the CBSI to be able to assess bank-specific risks in a forward-looking manner and reflect them in the minimum required levels of capital adequacy and liquidity buffers of banks.
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 was delivered for reviewing the weights of the currency basket and the FX market operations of the CBSI. The mission made several recommendations to improve the currency basket framework as well as FX market operations, regulations, and communication. Further TA is necessary to help implement these recommendations.
Macroeconomic Statistics	Statistics on the Real Sector and Government Finance	Strengthen compilation and dissemination of real sector statistics and the Government Finance Statistics	TA will continue in the compilation of the national accounts, debt statistics, and GFS. TA will also focus on improving forecasting capacity.
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 CBSI	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.
Financial Integrity	AML/CFT	Strengthen AML/CFT capacity	TA will continue to help establish a legal and regulatory framework meeting the FATF standards and develop and implement risk-based AML/CFT supervisory tools.
Governance and Anti-Corruption	Audit of public spending	Better audit of public spending	TA will continue to enhance capacity of the Auditor General's Office through providing advice and facilitating coordination among agencies.

Annex VI. Authorities' Response to Fund Policy Advice

Fund Recommendation	Policy Actions
Fiscal Policy	
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.	The authorities successfully hosted the Pacific Games and conducted peaceful general elections. However, strict expenditure controls introduced before the Games in the face of a possible cash crunch crowded out other priority spending and adversely affected economic activity.
Rebuild the government's cash balance once the recovery is secured after the Pacific Games.	The authorities are committed to safeguarding fiscal stability by reducing the budget deficit and rebuilding cash reserves. However, a credible plan and concrete measures to implement the commitment are lacking.
Public investment projects need to be phased in line with the economy's absorptive capacity, and accompanying financing arrangements should be carefully negotiated.	The government recently adopted the Public Investment Management Framework designed to establish effective control and oversight mechanisms for public investment projects financed by donors. The Debt Management Advisory Committee continues to assess the terms of external borrowing and their impacts on the government's financial position, but the assessment needs to be better integrated with the budget process.
Promote domestic revenue mobilization including through more efficient tax administration and the introduction of a VAT.	The Inland Revenue Division has continued efforts to modernize its organizational structure, with the support from development partners. The VAT bill has yet to be passed by Parliament, and the VAT is expected to be implemented from early 2026.
Reforms to improve the quality and accountability of public expenditure, including through improving PFM and reviewing the CDFs Act, need to be accelerated.	The CDFs Act was passed to improve transparency and accountability in management of the CDFs. The country continues to face fundamental weaknesses in financial management, such as the lack of timely and reliable fiscal reporting, weak cash management and forecasting, and the absence of an effective fiscal framework.
Monetary and Financial Sector Policy	
Strengthen the 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 and risk-based supervisory AML/CFT framework to better 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 and the CBSI's FX market operations were reviewed by TA mission, and several recommendations have been made to improve the currency basket framework and FX market operations, regulations, and communication.
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.	There has been mixed progress on reforms. The CDFs Act was passed to improve transparency and accountability in management of the CDFs. The Electricity Bill also passed Parliament to separate regulatory and pricing powers from the utility provider. However, the VAT bill has yet to be passed by Parliament and additional legislation to strengthen regulations and enforcement in the logging and mining sectors is still being drafted.

Annex VII. Data Issues

Table 1. Solomon Islands: Data Adequacy Assessment for Surveillance 1/

C							
Questionnaire Results 2/							
Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	C	B	C	B	B	C	C
Detailed Questionnaire Results							
Data Quality Characteristics							
Coverage	C	B	C	B	A		
Granularity 3/	C		C	C	A		
			A		C		
Consistency			D	B		C	
Frequency and Timeliness	D	B	D	B	B		

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.

1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.

2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance*, January 2024, Appendix I).

3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund is adequate for surveillance.
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.
C	The data provided to the Fund has some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. The quality of data in the Consumer Price Index, debt statistics, external sector statistics, and monetary and financial statistics is broadly adequate for surveillance. But the quality of national accounts and government finance statistics (GFS) falls short. While Gross Domestic Product (GDP) estimates are compiled using appropriate methodologies, those for 2021 and 2022 were not released until February 2024, due to the pandemic and capacity constraints. They differed significantly from the authorities' preliminary estimates, seemingly reflecting growth in the informal sector not observed in the preliminary estimates. The GDP price deflator is based on 2012 prices and needs rebasing. The CBSI publishes higher-frequency data such as on production activity, trade, and inflation, which help bridge some gaps in estimating GDP. The government did not publish the outcomes of the 2022 and 2023 budgets until November 2024, while the CBSI has regularly updated the GFS on a quarterly basis (the latest GFS data are for Q3 2024). The GFS data provided to the IMF includes granular data, although they are not fully consistent with the government budget data, partly due to insufficient data provision by the government.

Changes since the last Article IV consultation. With the capacity development support from the Pacific Financial Technical Assistance Centre (PFTAC), the CBSI has addressed discrepancies in grant figures between the balance of payments (BOP) statistics and the GFS by employing the a BOP donor survey. The introduction of a new Financial Management Information System (FMIS) has continued to affect the compilers' access to granular fiscal data, hampering their conversion to the GFS format, although the CBSI has recently started to map data in the system to the GFS format with the support of the PFTAC.

Corrective actions and capacity development priorities. The Fund's ongoing CD programs provided by the PFTAC and Statistics Department are already helping the authorities address some of the challenges mentioned above. Enhancing the statistical capacity and resources for the statistical function, in particular for the national accounts and the GFS, is critical. Coordination among stakeholders, including for the GFS across various government agencies, the central bank, and donors, needs to be strengthened.

Use of data and/or estimates different from official statistics in the Article IV consultation. None

Other data gaps. Data on labor market conditions, households, corporations, and state-owned enterprises would allow staff to conduct more detailed analysis of the economy. More granular data on digitalization of financial services would also be useful.

Table 2. Solomon Islands: Data Standards Initiatives

Solomon Islands participates in the Enhanced General Data Dissemination System (e-GDDS) and first posted its metadata in February 2012 but is yet to disseminate the data recommended under the e-GDDS.

Table 3. Solomon Islands: Table of Common Indicators Required for Surveillance

As of November 20, 2024

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	Solomon Islands[8]	Expected Timeliness[6,7]	Solomon Islands[8]
Exchange Rates	Dec-24	Dec-24	D	D	D	D	...	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Jun-24	Sep-24	M	M	M	M	1M	1Q
Reserve/Base Money	Jun-24	Sep-24	M	M	M	M	2M	2M
Broad Money	Aug-24	Sep-24	M	M	M	M	1Q	2M
Central Bank Balance Sheet	Aug-24	Sep-24	M	M	M	M	2M	2M
Consolidated Balance Sheet of the Banking System	Aug-24	Sep-24	M	M	M	M	1Q	2M
Interest Rates[2]	Mar-24	Jun-24	M	M	M	M	NA	2M
Consumer Price Index	Oct-24	Nov-24	M	M	M	M	2M	2M
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	NA	NA	NA	NA	A	A	3Q	12M
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	Dec-23	Mar-24	A	A	Q	A	1Q	1Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Mar-24	Jun-24	Q	Q	Q	Q	2Q	2W
External Current Account Balance	Jun-24	Sep-24	Q	Q	Q	A	1Q	24M
Exports and Imports of Goods and Services	Jun-24	Sep-24	Q	Q	M	M	12W	4M
GDP/GNP	Dec-22	Feb-24	A	A	Q	A	1Q	1Q
Gross External Debt	Mar-24	Sep-24	Q	Q	Q	Q	2Q	2W
International Investment Position	Jun-24	Sep-24	Q	Q	A	A	3Q	24M

[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 and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("I") irregular; and ("NA") not available.
[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.
[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

INTERNATIONAL MONETARY FUND

SOLOMON ISLANDS

January 27, 2025

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

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

Risk of external debt distress:	Low
Overall risk of debt distress:	Moderate
Granularity in the risk rating:	Tool not applicable
Application of judgement:	No

The 2024 Debt Sustainability Analysis (DSA) indicates that the overall risk of debt distress in Solomon Islands remains moderate, while the risk of external debt distress has improved to low from moderate in the 2023 DSA (IMF Country Report No. 23/162).[1] Debt coverage has remained unchanged compared to the 2023 DSA. All external debt indicators remain below the relevant indicative thresholds under the baseline and alternative scenarios, reflecting the better-than-expected export performance, leading to the upgrade of the external debt distress risk rating. The PV of public debt-to-GDP ratio remains below the indicative threshold under the baseline scenario but breaches the threshold under a commodity price shock scenario. A tailored natural disaster shock would also cause a deterioration in the public debt service-to-revenue ratio. Solomon Islands faces significant fiscal liquidity challenges stemming from the depleted government cash balance after hosting the 2023 Pacific Games. A sizable increase in domestic borrowing in 2023 and the continued shift to domestic financing projected in the medium term could bring about serious risks in domestic debt management, given the limited investor base and underdeveloped market. With pronounced uncertainty around the economic outlook, debt sustainability needs to be anchored by prudent fiscal policy to rebuild fiscal buffers, while creating fiscal space to meet development spending needs through stronger revenue mobilization measures and expenditure rationalization.

[1] Solomon Islands' Composite Index (CI) is estimated at 2.65 based on the October 2024 World Economic Outlook and the 2023 Country Policy and Institutional Assessment (CPIA), indicating that the debt-carrying capacity remains weak, as in the 2023 DSA, despite a minor improvement from 2.61 CI estimate in 2023.

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 2023 DSA. Due to data limitations, other elements of the general government, non-guaranteed state-owned enterprise (SOE) debt, and private external debt are not included in the analysis.[2] The authorities are continuing their efforts to improve data coverage, particularly for the general government, with support from the IMF. The DSA uses a residency-based definition of external debt but there is no material difference with the currency-based definition. 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.

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%.

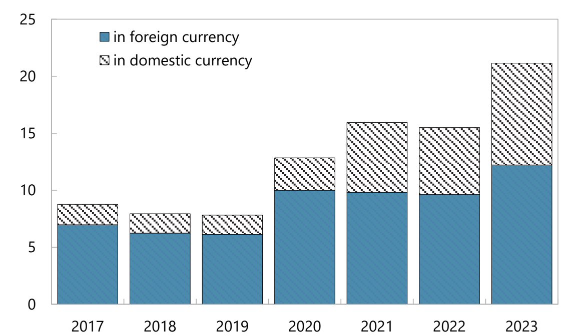
[2] Given the limited capacity of state and local governments, other SOEs, and the private sector to borrow and the underdeveloped domestic financing market, this limited debt coverage is not expected to have significant impacts on the assessment.

BACKGROUND ON DEBT

3. **Public and Publicly Guaranteed (PPG) external debt stood at US$193 million (11.7 percent of GDP) as of end-2023 (latest available full year data), an increase of 2.1 percent of GDP from 2022 (Table 1).** The Asian Development Bank (ADB) and the International Development Association (IDA) remained the largest creditors, accounting for 75 percent of total PPG external debt, with their share remaining roughly unchanged from 2022. Total PPG external debt rose by approximately US$45 million, of which US$33 million came from the ADB and IDA, while the remainder was from a new China Exim Bank loan for the cell phone tower project. All new external borrowing remained concessional.[3]

4. **Public debt stood at 20.3 percent of GDP as of end-2023, a 4.8 percent of GDP jump from 2022 (Table 2).** Public domestic debt jumped to SI$1,192 million (8.6 percent of GDP) at end-2023 from SI$751 million (5.9 percent of GDP) the year before. Large spending needs associated with hosting the Pacific Games, coupled with stagnant revenues since the pandemic and due to declining logging activity, accounted for the pick-up in debt. Most of the domestic debt increase was via new issuance of Solomon Islands Development Bonds purchased by the Solomon Islands National Provident Fund (NPF), the Electricity Authority, and the Port Authority, while the Central Bank of Solomon Islands (CBSI) purchased additional bonds in the secondary market.[4] By the end of 2023, the government has successfully cleared the pandemic-related stock of domestic payment arrears.

Text Figure 1. Solomon Islands: Public Debt Composition, 2017-2023
(In Percent of GDP)



Sources: Solomon Islands auhtorities and IMF staff estimates

5. **A rapid increase in domestic borrowing has driven the rise in debt in recent years, while external financing has also increased.** The Medium-Term Debt Management Strategy (MTDS) currently sets a limit for the public debt-to-GDP ratio at 35 percent in nominal terms, which provides an anchor for an annual borrowing limit set in the annual budgets and is used as direct guidance for Debt Management Unit operations.[5] The government gradually raised the limit from SI$300 million in 2020 to SI$865 million in 2023, but lowered it to SI$558 million in the 2024 budget. Donors have

[3] Solomon Islands adhered to a zero ceiling for non-concessional external borrowing in 2024, which was one of the Performance and Policy Actions (PPAs) under the World Bank's FY24 Sustainable Development Finance Policy (SDFP).

[4] Recent development bonds have maturities ranging from 2 to 15 years and coupons ranging from 2 percent to 7 percent. Commercial banks' holdings of the development bonds are minimal, accounting for only 3 percent of the total outstanding.

[5] Solomon Islands issued a Ministerial Order to develop annual borrowing plans in 2024, which was one of the PPAs under the World Bank's FY24 SDFP.

continued to finance large infrastructure projects through concessional lending, while the government will have to increasingly rely on domestic borrowing to finance its development expenditures.

Text Table 3. Public Debt: Share by Creditor (percent), 2020-23

	2020	2021	2022	2023
Multilateral Creditors	**64.0**	**51.5**	**52.6**	**47.1**
ADB	32.5	26.2	26.0	21.8
IDA	23.8	19.3	20.9	21.7
IMF	5.5	4.3	4.1	2.6
Other multilateral	2.1	1.7	1.6	1.1
Bilateral Creditors	**14.0**	**10.1**	**9.5**	**10.7**
China Exim Bank	-	-	-	4.4
China Exim Bank (Taiwan Province of China)	3.1	2.1	1.7	0.8
JICA	10.9	8.0	7.8	5.5
Government Securities	**22.1**	**38.4**	**37.9**	**42.2**
Total Central Government Debt	**100.0**	**100.0**	**100.0**	**100.0**

6. **The past debt trajectory remains largely unchanged despite the recent revisions to historical GDP and public finance statistics.** The Solomon Islands National Statistics Office (SINSO) released its GDP estimates for 2021 and 2022 in February 2024. These estimates indicate significantly better performance than the preliminary estimates by the authorities and the IMF, reflecting the resilience of the informal sector during the pandemic. However, nominal GDP remains broadly the same with lower-than-expected inflation (GDP deflator). The fiscal data have been also substantially revised since the previous DSA report, including historical data: the CBSI has extended the coverage of the government finance statistics (GFS) grants revenue to include some off-budget donor grants, thereby enhancing consistency between fiscal and BOP statistics. However, there are no significant changes in the fiscal balance up to 2020, since expenditures have also been revised to account for spending financed by these off-budget donor grants. Consequently, past external and public PPG debt trajectories are largely unchanged from those in the previous DSA (Figure 3).

COUNTRY CLASSIFICATION

7. **Solomon Islands' debt-carrying capacity remains weak.** The Composite Indicator (CI) index is 2.65, 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 (2023).

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	2.948	1.14	43%
Real growth rate (in percent)	2.719	1.967	0.05	2%
Import coverage of reserves (in percent)	4.052	57.963	2.35	89%
Import coverage of reserves^2 (in percent)	-3.990	33.597	-1.34	-51%
Remittances (in percent)	2.022	2.754	0.06	2%
World economic growth (in percent)	13.520	2.909	0.39	15%
CI Score			2.65	100%
CI rating			Weak	

Reference: Thresholds by Classiciation

EXTERNAL debt burden thresholds	Weak	Medium	Strong
PV of debt in % of			
Exports	140	180	240
GDP	30	40	55
Debt service in % of			
Exports	10	15	21
Revenue	14	18	23

METHODOLOGY AND ASSUMPTIONS

A. The Baseline

9. The country has navigated a series of shocks. The economy has faced multiple challenges, including civil unrest in the capital in November 2021, a local outbreak of COVID-19 in early 2022, and the spike in food and fuel prices due to Russia's invasion of Ukraine. Solomon Islands reopened its border in July 2022 after over two years of isolation. Additionally, the country successfully hosted the Pacific Games in November 2023 and conducted peaceful general elections in April 2024. Despite the shocks, the economy has recovered with better-than-expected growth rates of 2.6 percent in 2021 and 2.4 percent in 2022.[6] Output is estimated to grow by 2.7 percent in 2023, boosted by the stimulus from the Pacific Games.

10. The assumptions in the baseline scenario are consistent with the macroeconomic framework.[7] The discount rate used to calculate the net present value of external debt remains at 5 percent. The main assumptions are:

- **Real GDP** growth is projected to soften to 2.5 percent in 2024, with the slowdown partially attributed to reduced economic and government activity surrounding the general elections. The medium-term growth outlook appears moderate, constrained by structural impediments. Growth is expected to average 2.9 percent over 2024-34. While externally financed infrastructure projects are anticipated to support medium-term growth, declining logging activity due to dwindling

[6] These figures are based on the GDP estimates published by the SINSO in February 2024. See paragraph 6 about the estimates.

[7] The baseline does not explicitly model the effects of climate change and natural disasters beyond the average effects embedded in historical trends. This is due to a lack of in-depth country-specific analysis and a high degree of uncertainty about the positive effects of potential climate policies by the authorities. Instead, the impact of climate change is taken into account through a customized natural disaster stress test.

reserves, along with an undiversified economic base, limit growth potential. This outlook is based on expansion of the mining and tourism sectors, productivity gains in agriculture and fisheries, and an increasing young population entering the labor force, including in foreign markets.

- **Inflation** (measured by the GDP deflator) is expected to soften to 3.0 percent in 2024 driven by moderate global commodity prices and to average 2.3 percent during the period from 2024 to 2034.

- **Non-interest current account deficit** is projected to narrow to 4.0 percent of GDP in 2024, down from 10.2 percent of GDP in 2023, and to average 6.9 percent of GDP over the period from 2024 to 2034.[8] This improvement in 2024 has been supported by robust export performance and lower imports, driven by favorable fish and mineral exports and a decline in imports—particularly machinery—reflecting the slowdown in economic and government activity after the Pacific Games and around the general elections. Robust remittances, underpinned by an increasing number of seasonal workers under labor mobility schemes, are expected to contribute to a lower current account deficit. However, the deficit is projected to remain elevated in the medium term due to weak log exports and import needs for infrastructure projects. Increased remittances from the growing number of seasonal workers and mineral exports would partly offset the current account deficit. Official grants are projected to decline from 13.3 percent of GDP in 2023 to 9.5 percent of GDP in 2024 and average 9.5 percent of GDP over 2024-34, while FDI inflows, which spiked to 4.3 percent of GDP in 2023 with the Pacific Games infrastructure investments, are projected to decline to 0.9 percent of GDP in 2024 and remain steady at average 2.6 percent of GDP over 2024-34.

- **Fiscal outlook**: Fiscal deterioration due to the Pacific Games was less than expected in the previous DSA, with estimate of a primary deficit[9] of 3.5 percent of GDP in 2023, reflecting expenditure controls and additional donor support leading up to the Pacific Games. Expenditures continued to exceed revenues in 2024, even though the government was in caretaker mode during the first half of the year. Pressure on recurrent spending persists, and donor support has diminished. Fiscal deficits are expected to persist over the medium term with primary deficits at around 2.2 percent of GDP during the period from 2024 to 2034. The drivers of these persistent deficits include substantial expenditure needs to advance government priorities, maintenance costs for infrastructure, and continued weak revenue trends due to declining log exports. Solomon Islands faces significant challenges and risks stemming from the government's low cash balance, an undiversified economic base, and vulnerability to natural disasters and climate change.

[8] Compared with the previous vintage, the size of both exports and imports has increased significantly (around 6 percent of GDP for the period of 2022-27), mainly reflecting strong mineral exports and higher import prices, respectively. Nickel exports commenced in the fourth quarter of 2023, in addition to gold exports that restarted in late 2022.

[9] The fiscal data have been substantially revised since the last staff report, including historical data. See paragraph 6 for details.

- **External and domestic financing**: New external loan disbursements for projects[10] in the pipeline are expected to remain around 2.3 percent of GDP over the next five years (2024–28), gradually declining to around 1.7 percent of GDP in the following five-year period (2029-33). All external financing provided by multilateral institutions (e.g., IDA and ADB) and development partners is assumed to be concessional. 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,[11] to finance the development expenditures. 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	
	2022-27	2022-32	2022-27	2022-32	2022-27	2022-32
Real GDP growth, percent	1.6	2.3	2.7	2.8	1.1	0.5
Inflation (GDP deflator), percent	4.2	3.8	3.2	2.7	-1.0	-1.1
(In percent of GDP)						
Revenue and grants	26.5	26.4	34.2	33.6	7.7	7.2
Primary expenditure	30.1	29.3	36.8	36.0	6.7	6.7
Primary balance	-3.6	-2.9	-2.6	-2.4	0.9	0.5
Exports of goods and services	26.1	24.2	31.9	31.3	5.8	7.1
Imports of goods and services	43.1	39.9	48.5	47.8	5.4	7.9
Non-interest current account balance	-10.0	-8.4	-8.2	-7.7	1.7	0.7

11. The realism tools[12] suggest that the macroeconomic and fiscal assumptions are reasonable. The external and public PPG debt trajectory in the current DSA is largely consistent with the previous DSA (Figure 3); the public debt trajectory has improved somewhat, reflecting smaller primary deficits compared to the previous DSA. The projected five-year increases in external and public debt stocks are in line with the respective historical ones: public debt is forecast to increase driven by persistent primary deficits, while increases in external debt would be mostly offset by the

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

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

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

drawdown of foreign reserves[13] (Figure 3, middle charts). The projected fiscal adjustment over 2024-26 lies in the reasonable distribution of LIC's past adjustment episodes (Figure 4, left). Staff's real GDP growth projection during the years 2024–26 is broadly in line with the suggested multiplier analysis (Figure 4, right).

B. Tailored Stress Test[14]

12. Given the severity and frequency of natural disasters affected by climate change[15] in Solomon Islands, the natural disaster shock is tailored to better reflect country-specific factors. Solomon Islands, which is defined as a small developing natural disaster-prone state, is automatically subject to the standard natural disaster shock.[16,17] 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.[18] 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 1.5 and 3.5 percentage points, respectively.

DEBT SUSTAINABILITY

A. External Debt Sustainability Analysis

13. 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 trend up from 9.3 percent in 2024 to 11.1 percent in 2034. As Figure 3 shows, the main

[13] 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.

[14] 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. While we included the customized fiscal and financial risk scenario in the previous DSA to consider potential risks from the mismanagement of externally financed infrastructure projects and possible reductions in concessional financing, we do not include this scenario in this DSA as the risks and uncertainties were reduced, especially after the successful completion of the 2023 Pacific Games and the 2024 elections.

[15] The country has a high exposure to cyclones, heavy rainfalls, earthquakes, and tsunamis, accompanied by limited capacity to cope with them (see Annex III in the 2023 Solomon Islands Article IV Staff Report).

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

[17] One-off shock of 10 percentage points of GDP to debt-GDP ratio in the second year of the projection period (2025 in this case). Real GDP growth and exports growth are lowered by 1.5 and 3.5 percentage points, respectively, in the year of the shock.

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

driver of debt dynamics is the persistent current account deficit and foreign direct investment (FDI) inflows, on the back of continued infrastructure projects financed by donors.

14. Strong export performance has improved external debt profile under the standardized stress tests.[19] An exports shock is the most extreme shock to all the four external debt indicators, highlighting the need to expand the export base in the face of structural declines in log exports. However, all the indicators remain below the indicative thresholds under the export shock scenario, reflecting the better-than-expected export performance (see footnote 8) that has led to significant improvements in the export-to-GDP ratios and the export-related debt burden indicators. This contrasts with the previous DSA, where the PV of external debt-to-exports ratio reached the threshold under the export shock scenario (Figure 1). Other shocks, including to real GDP growth, primary balance, other flows, and commodity prices, do not lead to a breach, either.

15. A tailored natural disaster shock causes all the debt trajectories for debt indicators to move upward. Though the DSA assumes a one-off shock that takes place in 2025, there is a possibility that multiple severe natural disasters could occur within a 10-year timeframe. The Staff's work (see footnote 16) shows that there is a probability of around 13.5 percent of a disaster each year of a magnitude of more than 7 percent of GDP. 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

16. The PV of public debt-to-GDP ratio is forecast to keep rising under the baseline scenario, although it is expected that it will take longer to hit the 35 percent benchmark compared to the previous DSA (Figure 2). The ratio is projected to exceed the benchmark in 2044, compared to 2034 in the last vintage. The improvement is partly driven by the better-than-expected fiscal performance, brought about by strict expenditure controls—on spending not related to the 2023 Pacific Games or the Constituency Development Funds (CDFs)—that hampered economic activity, limited investor appetite to the domestic bonds, and generous donor support with larger-than-expected concessional financing. In nominal terms, the ratio of public debt-to-GDP is projected to breach the authorities' policy threshold of 35 percent in 2032, reflecting persistent primary deficits. Public debt service-to-revenue and grants ratio is projected to increase in the coming decade, driven by projected shifts from highly concessional external debt to more expensive domestic borrowing.

17. 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 in 2028 under the commodity price shock scenario (Figure 2, Table 4). The PV of debt-to-revenue ratio would also be severely affected by the commodity price shock. As a small exporter of multiple commodities that now include gold and nickel, the country is highly exposed to international price

[19] 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.

fluctuations. 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.

18. **The natural disaster shock scenario flags major risks to debt sustainability.** In the natural disaster shock scenario, the debt service-to-revenue ratio would peak at 24 percent in 2031 (Figure 2, Table 4). This result highlights the importance of rebuilding fiscal buffers against external shocks, including natural disasters.

RISK RATING AND VULNERABILITIES

19. **The 2024 DSA indicates that the overall risk of debt distress in Solomon Islands remains moderate, while the risk of external debt distress has improved from moderate to low.** All indicators of both external and overall debt are projected to remain below the relevant thresholds during 2024-34 under the baseline. Although debt service indicators are currently below their thresholds, maximizing concessional loans would help to keep the debt burden manageable. Improvements in data quality will also be critical to address non-negligible residuals.

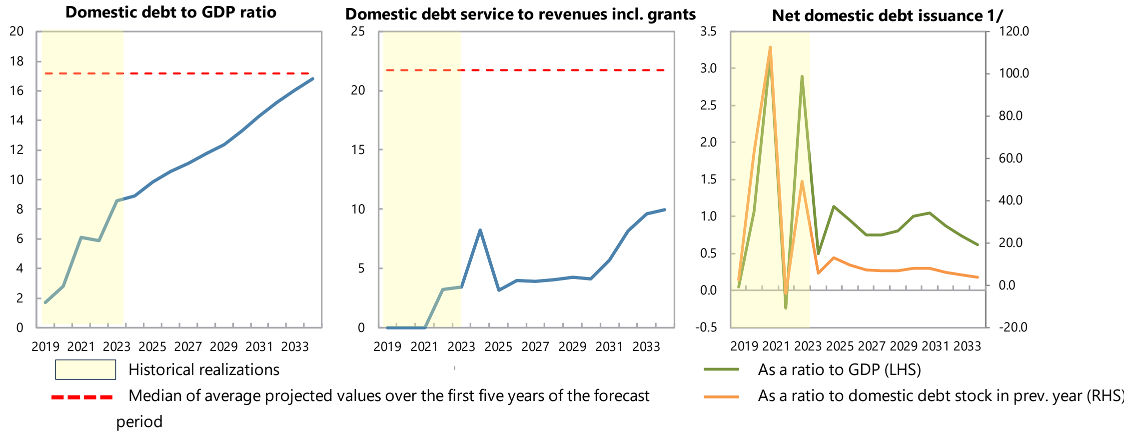
20. **Stress tests highlight vulnerabilities of Solomon Islands.** Various scenarios, including commodity price and natural disaster shocks, could significantly undermine public debt sustainability, particularly in light of projected continuous fiscal deficits. These vulnerabilities underscore the need for measures to rebuild fiscal buffers, enhance medium-term potential growth, and prioritize investment projects that strengthen resilience to natural disasters. Furthermore, prudent public investment management, including careful consideration of financing terms, is critically important.

21. **The public debt portfolio currently faces limited refinancing and interest rate risks; however, these risks are rapidly increasing**. Approximately 58 percent of public debt is external loans that are contracted at concessional terms. Yields of government securities have remained broadly constant over the past years (e.g., yields for T-bills 91 days were 0.50 percent at end-2023 and 0.49 percent at end-2022). Staff expects that this favorable situation for the government would not persist for long, as the reliance on domestic borrowing is expected to increase, which could lead to higher interest rates and expose the government to refinancing risks.

22. **The new domestic debt tool (Text Figure 2) illustrates the risks and vulnerabilities associated with rapidly rising domestic debt, emphasizing the need for a fiscal consolidation.** The projected increase in domestic debt to finance the deficits may lead to higher domestic debt service costs in the future. In addition, this increase raises concerns about the sustainability of financing from the domestic market, given the narrow investor base and the underdeveloped financial market.[20] This underscores the need for initiating a gradual fiscal adjustment, while ensuring prudent debt management by prioritizing highly concessional external borrowing.

[20] The authorities' Medium Term Debt Strategy sets out some measures for domestic market development, including formulating and reviewing the bond policy to attract more participation in both the bond market and T-bill market.

Text Figure 2. Solomon Islands: Indicators of Domestic Public Debt, 2019-2034
(Percent)



Borrowing Assumptions (average over 10-year	Value
Shares in new domestic debt issuance	
Medium and long-term	83%
Short-term	17%
Borrowing terms	
Domestic MLT debt	
Avg. real interest rate on new borrowing	2.9%
Avg. maturity (incl. grace period)	6
Avg. grace period	5
Domestic short-term debt	
Avg. real interest rate	1.5%

Sources:
1/ Net domestic debt issuance is an estimate based on the calculated public gross financing need net of gross external financing, drawdown of assets, other adjustments and domestic debt amortization. It excludes short-term debt that was issued and matured within the calendar year.

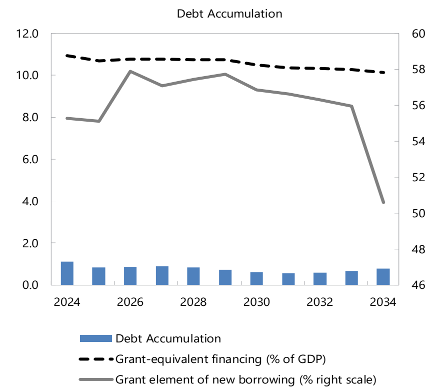
AUTHORITIES' VIEWS

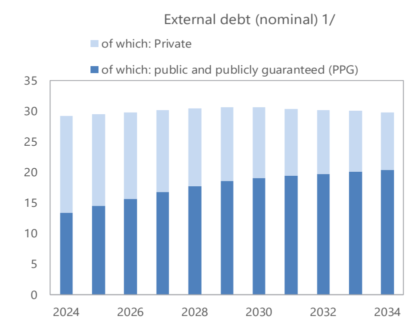
23. **The authorities agreed with the thrust of staff's analysis of Solomon Islands' debt sustainability.** The authorities reaffirmed their commitment to ensuring a sustainable debt position through prudent debt management under the revised Medium-Term Debt Strategy (MTDS) and the debt threshold of 35 percent of GDP. This commitment involves the avoidance of non-concessional external borrowing and careful appraisal and monitoring of infrastructure projects under the Public Investment Management Framework, as well as expenditure rationalization underpinned by a fiscal anchor and continued efforts to mobilize domestic revenues. Recognizing the risks associated with increasing domestic financing, the authorities are intensifying their efforts to develop the domestic debt market. This includes annually updating the MTDS, strengthening coordination among relevant agencies, enhancing market transparency, and improving communication with potential investors. The government is also exploring other sources of concessional financing, such as climate finance, to address substantial investment needs, particularly for climate adaptation.

Table 1. Solomon Islands: External Debt Sustainability Framework, Baseline Scenario, 2021–44
(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/	
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2034	2044	Historical	Projections
External debt (nominal) 1/	27.6	27.5	28.4	29.2	29.5	29.8	30.1	30.5	30.7	29.8	25.1	22.3	30.1
of which: public and publicly guaranteed (PPG)	9.8	9.6	11.7	13.4	14.5	15.6	16.7	17.7	18.6	20.4	19.5	8.4	17.8
Change in external debt	-0.6	-0.1	0.9	0.8	0.3	0.3	0.3	0.3	0.2	-0.2	-0.7		
Identified net debt-creating flows	3.8	10.3	4.4	2.6	4.7	4.1	3.9	3.8	3.7	3.6	1.5	3.2	3.7
Non-interest current account deficit	5.0	13.5	10.2	4.0	7.4	7.2	7.1	7.2	7.0	7.1	5.7	5.6	6.9
Deficit in balance of goods and services	13.4	22.3	19.8	11.6	15.3	15.3	15.6	16.1	16.5	16.8	16.0	10.5	15.8
Exports	26.9	25.8	32.6	34.6	33.2	32.8	32.1	31.4	30.7	29.6	28.3		
Imports	40.4	48.1	52.3	46.2	48.6	48.1	47.7	47.5	47.2	46.4	44.3		
Net current transfers (negative = inflow)	-7.2	-8.0	-7.9	-7.0	-7.1	-7.4	-7.6	-8.1	-8.5	-8.9	-9.2	-5.2	-8.2
of which: official	-11.1	-15.2	-13.3	-8.0	-8.0	-8.0	-8.0	-8.0	-8.0	-7.9	-7.7		
Other current account flows (negative = net inflow)	-1.3	-0.7	-1.7	-0.6	-0.8	-0.7	-0.9	-0.8	-0.9	-0.8	-1.1	0.3	-0.8
Net FDI (negative = inflow)	-1.5	-2.6	-4.3	-0.9	-2.3	-2.6	-2.7	-2.8	-2.9	-2.9	-3.7	-2.0	-2.6
Endogenous debt dynamics 2/	0.4	-0.6	-1.4	-0.4	-0.5	-0.5	-0.5	-0.5	-0.5	-0.6	-0.5		
Contribution from nominal interest rate	0.1	0.2	0.2	0.2	0.3	0.3	0.4	0.3	0.4	0.3	0.2		
Contribution from real GDP growth	-0.7	-0.6	-0.7	-0.7	-0.8	-0.8	-0.8	-0.9	-0.9	-0.9	-0.7		
Contribution from price and exchange rate changes	1.0	-0.1	-0.9	...	...	...	...	...	...	...	...		
Residual 3/	-4.5	-10.4	-3.6	-1.9	-4.4	-3.8	-3.5	-3.5	-3.5	-3.8	-2.2	-1.8	-3.6
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	...	...	8.8	9.3	9.7	9.9	10.2	10.5	10.7	11.1	10.6		
PV of PPG external debt-to-exports ratio	...	...	26.9	27.0	29.1	30.3	31.9	33.5	34.7	37.5	37.7		
PPG debt service-to-exports ratio	1.6	1.7	1.4	1.5	1.9	1.7	1.8	1.9	2.4	2.0	2.6		
PPG debt service-to-revenue ratio	1.8	1.9	2.0	2.3	2.7	2.5	2.6	2.6	3.2	2.5	2.9		
Gross external financing need (Million of U.S. dollars)	91.0	232.8	165.2	111.9	155.1	149.5	150.6	155.9	161.3	188.7	185.4		
Key macroeconomic assumptions													
Real GDP growth (in percent)	2.6	2.4	2.7	2.5	2.8	2.9	2.9	3.0	3.0	3.0	3.0	2.0	2.9
GDP deflator in US dollar terms (change in percent)	-3.3	0.4	3.3	3.0	2.6	2.6	2.7	2.3	2.3	2.1	2.3	0.6	2.3
Effective interest rate (percent) 4/	0.5	0.6	0.6	0.9	1.1	1.1	1.3	1.1	1.3	0.9	1.0	1.2	1.1
Growth of exports of G&S (US dollar terms, in percent)	-6.3	-1.5	33.9	12.0	1.4	4.4	3.6	3.0	3.1	4.5	5.0	0.6	4.4
Growth of imports of G&S (US dollar terms, in percent)	8.1	22.5	15.5	-6.9	11.0	4.7	4.8	4.9	4.7	4.8	4.9	3.0	4.3
Grant element of new public sector borrowing (in percent)	...	...	...	55.3	55.1	57.9	57.1	57.4	57.7	50.6	51.1	...	56.1
Government revenues (excluding grants, in percent of GDP)	24.8	23.1	22.9	23.2	23.0	23.1	23.2	23.3	23.3	24.1	25.0	26.7	23.4
Aid flows (in Million of US dollars) 5/	312.5	375.8	379.1	212.1	213.8	226.7	238.4	247.6	260.7	317.2	483.8		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	10.9	10.7	10.8	10.8	10.7	10.8	10.1	9.4	...	10.6
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	90.4	91.7	92.1	91.9	92.2	92.1	92.6	94.4	...	92.4
Nominal GDP (Million of US dollars)	1,523	1,566	1,661	1,753	1,850	1,954	2,067	2,177	2,294	2,938	4,922		
Nominal dollar GDP growth	-0.9	2.9	6.0	5.6	5.5	5.7	5.8	5.3	5.4	5.1	5.4	2.7	5.3
Memorandum items:													
PV of external debt 7/	...	...	25.4	25.1	24.6	24.1	23.6	23.2	22.7	20.5	16.3		
In percent of exports	...	...	78.0	72.7	74.1	73.5	73.5	74.0	74.0	69.4	57.6		
Total external debt service-to-exports ratio	9.3	15.3	12.6	9.5	9.8	9.3	9.2	9.0	9.3	7.6	6.1		
PV of PPG external debt (in Million of US dollars)			145.4	163.8	178.6	194.4	211.6	229.1	244.6	326.1	524.1		
(PVt-PVt-1)/GDPt-1 (in percent)				1.1	0.8	0.9	0.9	0.8	0.7	0.8	0.4		
Non-interest current account deficit that stabilizes debt ratio	5.6	13.6	9.3	3.2	7.1	6.9	6.7	6.9	6.8	7.3	6.4		

Definition of external/domestic debt	**Residency-based**
Is there a material difference between the two criteria?	**No**





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) + Εα (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, Ε=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.

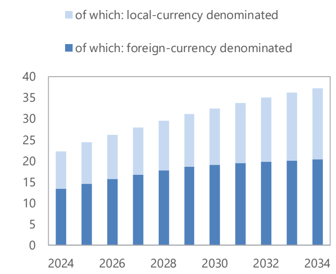
Table 2. Solomon Islands: Public Sector Debt Sustainability Framework, Baseline Scenario, 2021–44

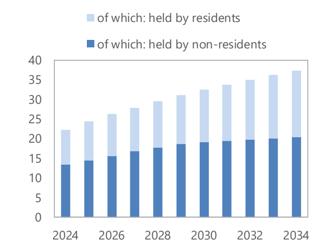
(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2034	2044	Historical	Projections
Public sector debt 1/	**15.9**	**15.5**	**20.3**	**22.3**	**24.4**	**26.2**	**27.9**	**29.5**	**31.0**	**37.2**	**44.4**	**11.5**	**30.5**
of which: external debt	**9.8**	**9.6**	**11.7**	**13.4**	**14.5**	**15.6**	**16.7**	**17.7**	**18.6**	**20.4**	**19.5**	**8.4**	**17.8**
Change in public sector debt	3.1	-0.4	4.8	2.0	2.1	1.9	1.6	1.6	1.5	1.1	0.7		
Identified debt-creating flows	**2.2**	**2.1**	**2.8**	**2.1**	**2.2**	**2.0**	**1.8**	**1.7**	**1.6**	**1.1**	**0.8**	**1.0**	**1.6**
Primary deficit	**1.6**	**2.2**	**3.5**	**2.6**	**2.7**	**2.6**	**2.4**	**2.3**	**2.3**	**1.7**	**1.1**	**1.2**	**2.2**
Revenue and grants	35.9	38.3	36.3	32.7	32.5	32.6	32.7	32.8	32.8	33.4	33.8	**37.7**	**32.9**
of which: grants	11.1	15.2	13.4	9.5	9.5	9.5	9.5	9.5	9.5	9.3	8.8		
Primary (noninterest) expenditure	37.5	40.4	39.8	35.3	35.2	35.2	35.1	35.1	35.1	35.0	34.9	**38.9**	**35.1**
Automatic debt dynamics	**0.6**	**-0.1**	**-0.7**	**-0.5**	**-0.6**	**-0.6**	**-0.6**	**-0.6**	**-0.6**	**-0.6**	**-0.3**		
Contribution from interest rate/growth differential	-0.5	-0.7	-0.7	-0.5	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0.3		
of which: contribution from average real interest rate	-0.2	-0.4	-0.3	0.0	0.1	0.1	0.1	0.2	0.2	0.5	1.0		
of which: contribution from real GDP growth	-0.3	-0.4	-0.4	-0.5	-0.6	-0.7	-0.7	-0.8	-0.9	-1.1	-1.3		
Contribution from real exchange rate depreciation	1.1	0.7	0.0	...	...	...	...	...	...	...	...		
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 (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	**0.9**	**-2.5**	**2.0**	**-0.1**	**-0.1**	**-0.1**	**-0.2**	**-0.1**	**-0.1**	**0.0**	**-0.1**	**-0.1**	**-0.1**
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	**...**	**...**	**17.4**	**18.3**	**19.6**	**20.6**	**21.5**	**22.4**	**23.2**	**28.0**	**35.6**		
PV of public debt-to-revenue and grants ratio	**...**	**...**	**47.9**	**56.0**	**60.3**	**63.3**	**65.6**	**68.3**	**70.6**	**84.0**	**105.4**		
Debt service-to-revenue and grants ratio 3/	**1.2**	**4.3**	**4.7**	**9.8**	**5.0**	**5.7**	**5.7**	**5.9**	**6.5**	**11.7**	**18.2**		
Gross financing need 4/	2.1	3.8	5.2	3.8	4.4	4.5	4.3	4.3	4.4	5.6	7.3		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	2.6	2.4	2.7	2.5	2.8	2.9	2.9	3.0	3.0	3.0	3.0	**2.0**	**2.9**
Average nominal interest rate on external debt (in percent)	0.8	1.1	1.2	1.7	2.0	1.9	2.1	1.8	2.1	1.2	1.2	**1.1**	**1.7**
Average real interest rate on domestic debt (in percent)	5.8	2.6	-0.9	0.6	0.6	0.7	0.9	1.8	1.7	3.9	4.7	**-0.9**	**2.0**
Real exchange rate depreciation (in percent, + indicates depreciation)	11.3	7.2	-0.1	...	...	...	...	...	...	...	...	**2.2**	**...**
Inflation rate (GDP deflator, in percent)	-5.5	2.0	6.1	3.0	2.6	2.6	2.7	2.3	2.3	2.1	2.3	**2.0**	**2.3**
Growth of real primary spending (deflated by GDP deflator, in percent)	-4.2	10.2	1.2	-9.0	2.5	2.9	2.6	3.0	3.0	3.0	3.0	**1.8**	**1.8**
Primary deficit that stabilizes the debt-to-GDP ratio 5/	-1.5	2.6	-1.3	0.6	0.7	0.8	0.8	0.7	0.7	0.6	0.4	**-0.1**	**0.7**
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	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?	**No**

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, 2024–34

(In percent)

	Projections 1/										
	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
PV of debt-to GDP ratio											
Baseline	9	10	10	10	11	11	11	11	11	11	11
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	9	9	9	9	10	10	9	9	9	9	9
B. Bound Tests											
B1. Real GDP growth	9	10	11	11	12	12	12	12	12	12	12
B2. Primary balance	9	10	11	12	12	12	12	12	13	13	13
B3. Exports	9	13	19	19	19	19	19	19	19	19	19
B4. Other flows 3/	9	12	15	15	16	16	16	16	16	16	16
B5. Depreciation	9	12	9	10	10	10	11	11	11	11	11
B6. Combination of B1-B5	9	14	16	16	16	16	16	16	16	16	17
C. Tailored Tests											
C1. Combined contingent liabilities	9	12	12	12	13	13	13	13	14	14	14
C2. Natural disaster	9	13	14	14	15	15	15	16	17	17	17
C3. Commodity price	9	10	10	11	11	11	10	10	10	9	9
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	27	29	30	32	33	35	35	36	36	37	38
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	27	28	28	29	30	31	31	31	31	31	31
B. Bound Tests											
B1. Real GDP growth	27	29	30	32	33	35	35	36	36	37	38
B2. Primary balance	27	32	34	36	38	39	40	41	42	43	44
B3. Exports	27	44	79	81	84	86	87	87	88	89	90
B4. Other flows 3/	27	37	47	48	50	51	52	52	53	53	54
B5. Depreciation	27	29	23	24	26	27	28	28	28	29	30
B6. Combination of B1-B5	27	43	43	55	57	59	60	60	61	61	62
C. Tailored Tests											
C1. Combined contingent liabilities	27	35	36	38	40	41	43	45	45	46	47
C2. Natural disaster	27	40	43	45	48	49	51	55	57	58	60
C3. Commodity price	27	29	32	33	34	34	34	33	32	31	31
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	2	2	2	2	2	2	2	2	2	2
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	2	2	2	2	2	3	3	3	3	2	2
B. Bound Tests											
B1. Real GDP growth	2	2	2	2	2	2	2	2	2	2	2
B2. Primary balance	2	2	2	2	2	2	2	2	2	2	2
B3. Exports	2	2	3	3	3	4	4	4	4	3	3
B4. Other flows 3/	2	2	2	2	2	3	3	2	2	2	2
B5. Depreciation	2	2	2	2	2	2	2	2	2	2	2
B6. Combination of B1-B5	2	2	2	3	3	3	3	3	3	3	3
C. Tailored Tests											
C1. Combined contingent liabilities	2	2	2	2	2	3	2	2	2	2	2
C2. Natural disaster	2	2	2	2	2	3	3	3	3	2	2
C3. Commodity price	2	2	2	2	2	3	2	2	2	2	2
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	3	2	3	3	3	3	3	3	2	2
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	2	3	3	3	3	3	3	3	3	3	3
B. Bound Tests											
B1. Real GDP growth	2	3	3	3	3	4	3	3	3	3	3
B2. Primary balance	2	3	3	3	3	3	3	3	3	3	3
B3. Exports	2	3	3	3	3	4	4	4	3	3	3
B4. Other flows 3/	2	3	3	3	3	4	3	3	3	3	3
B5. Depreciation	2	3	3	3	3	4	4	3	3	3	3
B6. Combination of B1-B5	2	3	3	3	3	4	4	3	3	3	3
C. Tailored Tests											
C1. Combined contingent liabilities	2	3	3	3	3	3	3	3	3	3	3
C2. Natural disaster	2	3	3	3	3	3	3	3	3	3	3
C3. Commodity price	2	3	3	3	3	3	3	3	3	3	2
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, 2024–34
(In percent)

	Projections 1/										
	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
	PV of Debt-to-GDP Ratio										
Baseline	18	20	21	21	22	23	24	25	26	27	28
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	18	18	18	19	19	19	20	20	22	23	24
B. Bound Tests											
B1. Real GDP growth	18	21	25	28	31	33	**36**	**39**	**41**	**44**	**46**
B2. Primary balance	18	21	23	24	25	26	27	28	28	29	30
B3. Exports	18	22	28	29	30	30	31	32	33	34	35
B4. Other flows 3/	18	22	26	27	28	28	29	30	31	32	33
B5. Depreciation	18	20	19	19	19	19	18	19	19	19	19
B6. Combination of B1-B5	18	19	21	21	21	22	23	24	25	26	27
C. Tailored Tests											
C1. Combined contingent liabilities	18	24	25	26	27	28	29	29	30	31	32
C2. Natural disaster	18	30	31	32	33	34	**35**	**35**	**36**	**37**	**38**
C3. Commodity price	18	22	27	32	**36**	**40**	**43**	**46**	**48**	**51**	**53**
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	56	60	63	66	68	71	73	76	79	81	84
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	56	56	56	57	57	58	58	60	64	66	69
B. Bound Tests											
B1. Real GDP growth	56	64	75	82	90	98	105	113	120	127	134
B2. Primary balance	56	64	72	74	77	79	81	83	86	88	91
B3. Exports	56	68	86	88	91	93	95	98	100	102	105
B4. Other flows 3/	56	68	80	82	84	86	89	91	94	96	99
B5. Depreciation	56	64	61	61	60	59	57	58	59	59	59
B6. Combination of B1-B5	56	60	64	63	66	68	71	73	75	78	81
C. Tailored Tests											
C1. Combined contingent liabilities	56	75	78	80	83	85	87	88	90	93	95
C2. Natural disaster	56	93	95	98	101	104	107	107	109	112	115
C3. Commodity price	56	71	86	101	112	122	130	137	144	151	158
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	10	5	6	6	6	6	6	8	10	11	12
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	10	5	5	5	5	6	8	6	8	10	10
B. Bound Tests											
B1. Real GDP growth	10	5	7	7	8	9	11	12	16	17	18
B2. Primary balance	10	5	7	7	7	7	9	11	13	12	12
B3. Exports	10	5	6	6	6	7	7	8	10	12	12
B4. Other flows 3/	10	5	6	6	6	7	6	8	10	12	12
B5. Depreciation	10	5	6	6	6	7	8	8	8	11	11
B6. Combination of B1-B5	10	5	6	6	6	7	8	8	10	11	12
C. Tailored Tests											
C1. Combined contingent liabilities	10	5	9	7	7	7	9	16	12	12	13
C2. Natural disaster	10	5	11	8	8	8	10	24	15	14	14
C3. Commodity price	10	6	8	9	9	10	12	15	20	22	22
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.

Figure 1. Solomon Islands: Indicators of Public and Publicly Guaranteed External Debt Under Baseline Scenarios, 2024–34 1/

Customization of Default Settings		
	Size	Interactions
Tailored Stress		
Combined CL	No	
Natural disaster	Yes	No
Commodity price	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.

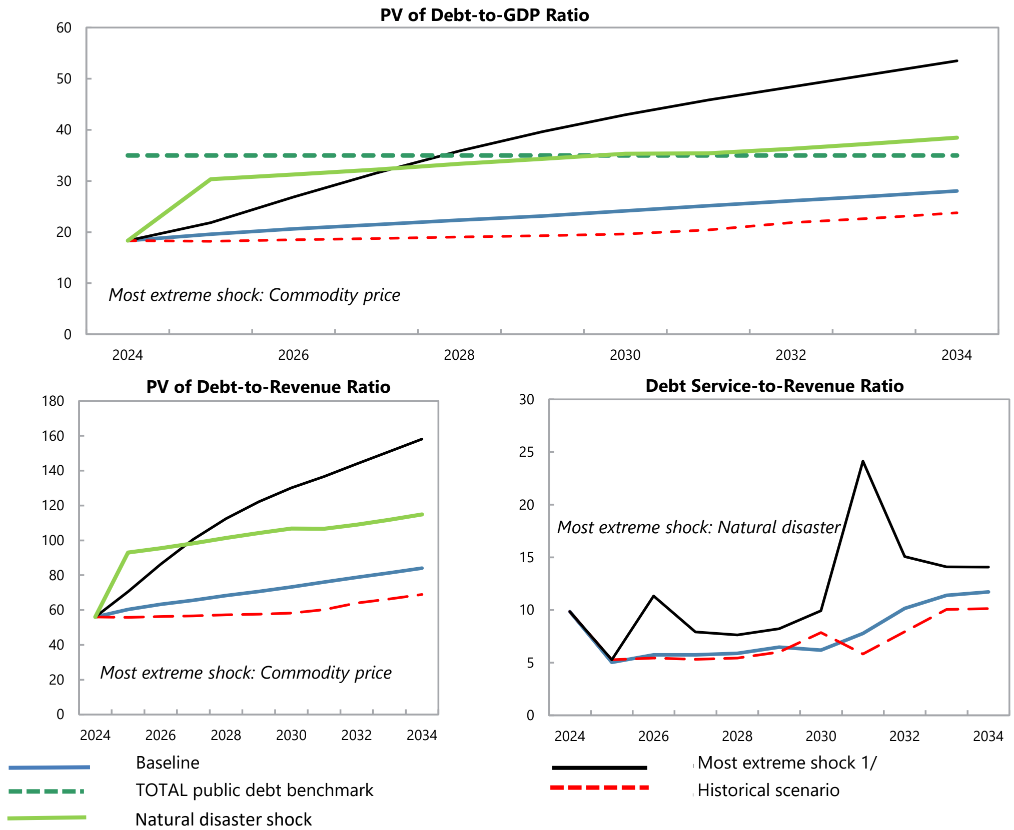
Borrowing assumptions on additional financing needs resulting from the stress tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	0.9%	0.9%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	36	36
Avg. grace period	9	9

* 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 2034. 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 2. Solomon Islands: Indicators of Public Debt Under Baseline Scenarios, 2024–34 1/



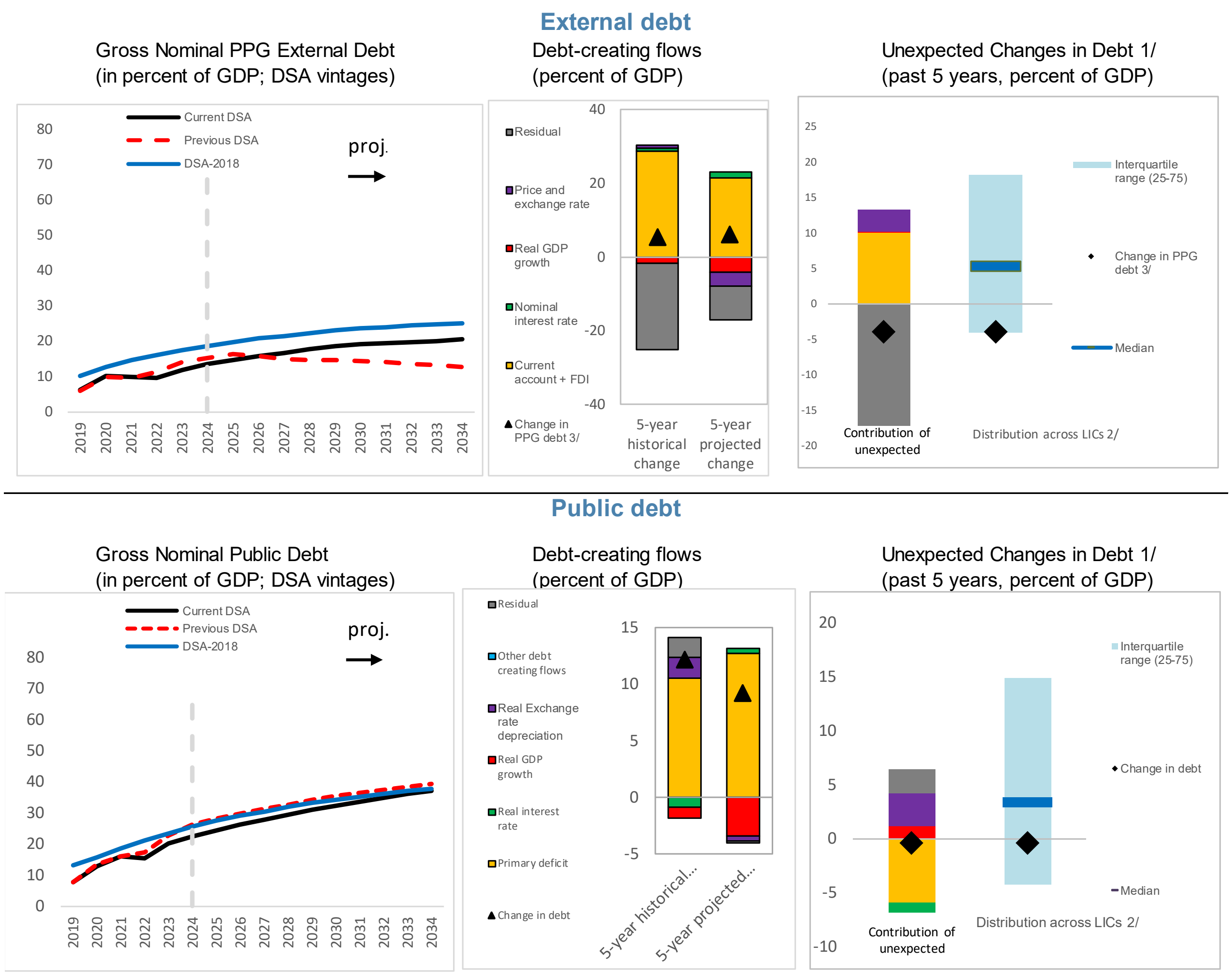
Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	45%	45%
Domestic medium and long-term	46%	46%
Domestic short-term	10%	10%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	0.9%	0.9%
Avg. maturity (incl. grace period)	36	36
Avg. grace period	9	9
Domestic MLT debt		
Avg. real interest rate on new borrowing	2.9%	2.9%
Avg. maturity (incl. grace period)	6	6
Avg. grace period	5	5
Domestic short-term debt		
Avg. real interest rate	1.5%	1.5%

* 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 2034. 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



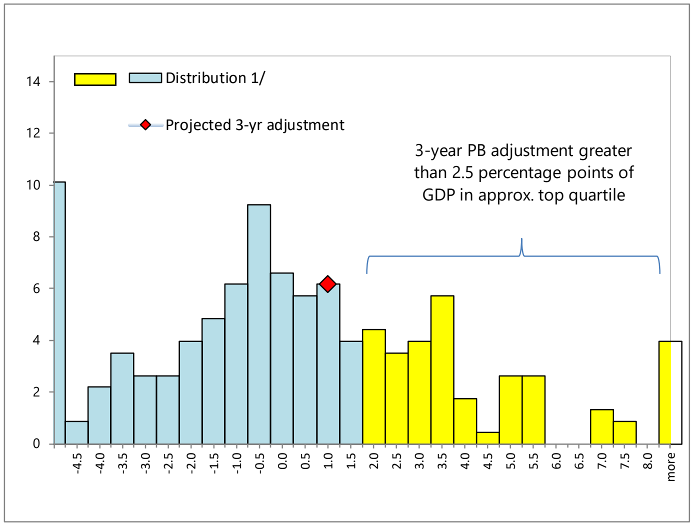
1/ Difference between anticipated and actual contributions on debt ratios.

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.

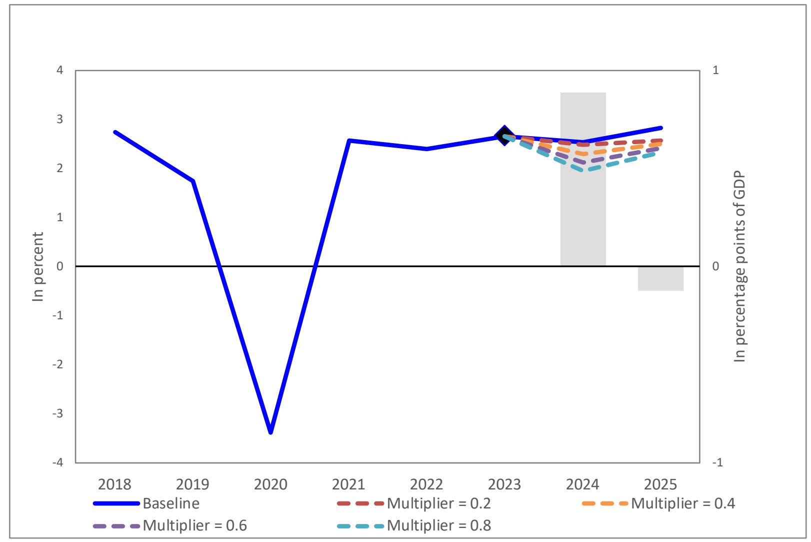
Figure 4. Solomon Islands: Realism tools

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) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

INTERNATIONAL MONETARY FUND

SOLOMON ISLANDS

January 27, 2025

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

Asia and Pacific Department (in consultation with other departments)

CONTENTS

FUND RELATIONS

(As of November 30, 2024)

Membership Status: Joined September 22, 1978; Article VIII

General Resources Account:

	SDR Million	Percent of Quota
Quota	20.80	100.00
IMF's Holdings of Currency	22.85	109.87
Reserve Tranche Position	3.15	15.14

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	29.84	100.00
Holdings	0.07	0.23

Outstanding Purchases and Loans:

	SDR Million	Percent of Quota
Emergency Assistance[1/]	5.20	25.01
RCF Loans	6.93	33.32
ECF Arrangements	0.10	0.50

[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: [1/]

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				
	2024	2025	2026	2027	2028
Principal	1.73	4.23	1.42	1.39	1.39
Charges/Interest		1.07	1.00	1.00	1.00
Total	1.73	5.31	2.42	2.39	2.39

[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), the Australian dollar (AUD), and the New Zealand dollar. The latest review and re-weighting of the basket weights was done on August 21, 2024. 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 ±24 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 2023, the exchange rate followed a depreciating trend within a 2 percent band against the US dollar. Accordingly, the de facto exchange rate arrangement was reclassified to "crawl-like" from "other managed", effective March 31, 2023. 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 2023 Article IV Consultation discussions were held during February 8–21, 2023, and the consultation was concluded on April 26, 2023 (IMF Country Report No. 23/162).

Safeguards Assessment:

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.

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:

  Pacific Islands: Development news, research, data | World Bank

- Asian Development Bank:

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

- Pacific Financial Technical Assistance Center:

  https://www.pftac.org/

Statement by Ms. Luu, Alternate Executive Director for Asia and the Pacific and Ms. Doss, Senior Advisor to the Executive Director
February 19, 2025

Solomon Islands is grateful to mission chief Mr. Yabara and his team for their open and constructive engagement on the recent Article IV mission. The authorities welcome staff's report and concur with their findings and in-depth assessment of Solomon Islands' economy, noting that it provides them with a clear roadmap to pursue economic reforms, fiscal strengthening and sound macroeconomic changes to sustainably grow the economy.

Solomon Islands is a fragile, small developing state, with a population of around 735,000 that speaks over 120 different languages. The country comprises a landmass of less than 30,000 square kilometers spread out over 1 million square kilometers of the South Pacific Ocean. The country's dispersed population, large infrastructure needs, narrow economic base, and exposure to natural disasters pose many development challenges. Efforts by the authorities to diversify the economy, provide quality and reliable infrastructure and support private sector led growth are further constrained by political instability and weak governance.

Since the last AIV consultation, the authorities have successfully delivered the Pacific Games in November 2023 and conducted a peaceful general election in April 2024. The authorities agree with staff's assessment that these two substantial achievements have raised the country's profile and strengthened national unity and they intend to build from here to advance reforms to successfully address Solomon Islands' longstanding economic and fiscal challenges.

Context and outlook

The authorities are more optimistic about the economic outlook compared to staff. While acknowledging the risks to the outlook, the Government estimates that the ongoing economic recovery following the pandemic will remain stable. In the 2025 Budget, the Government projects real GDP growth at 3.8 per cent in 2025, 4.3 per cent in 2026 and 4.0 per cent in 2027 – an upgrade from the last budget, and higher than the average 2.5 per cent growth prior to the pandemic.

The positive outlook is largely due to expected stronger mining activity and exports, as the Gold Ridge and nickel mines reach full production in 2025. Authorities expect growth in fisheries output, with increased fish catches reflecting expected good weather conditions, higher demand domestically and for exports, and additional fishing boats. The economy will also benefit from national infrastructure projects, particularly following the commencement of the Tina Hydro project. By contrast, forestry and logging activities are expected to continue to decline, as forests continue to be depleted. Output from construction and other business services is also expected to slow down.

Inflation has declined as food and fuel prices have stabilized. The Central Bank of the Solomon Islands expects headline inflation to ease to 2.5 per cent by the end of 2024 and to stay close to 2 per cent in March 2025 when the Monetary Policy Stance is next updated. In the near-term, food, housing and energy are expected to drive inflation, while the broader outlook remains modest.

Improvements to transport and retail infrastructure around Honiara are expected to improve the supply of garden crops and vegetables.

Fiscal

The Government cautiously welcomes staff's assessment that the overall risk of debt distress remains unchanged, while the risk of external debt distress has been upgraded. Given Solomon Islands' reliance on external financing, the Government is concerned by the extent to which an upgrade to the external debt rating will trigger higher costs of borrowing from bilateral and multilateral partners in the medium term. The Government is exploring ways in which it can keep borrowing costs low and access new sources of concessional financing. Solomon Islands has high infrastructure investment needs, a fixed exchange rate, a low revenue base and under-developed capital market, and growing contingent liabilities, and remains vulnerable to shocks. The Government agrees with staff that debt-to-GDP could breach their target of 35 per cent within the next 10 years under current policy. To prevent this from happening, the Government is committed to improving public financial management and diversifying the economy to support policy settings that keep debt-to-GDP below the target. The Government is working with the Asian Development Bank to review and update fiscal targets and has requested a Public Expenditure and Financial Accountability assessment with PFTAC to review its PFM practices in 2025.

Domestic revenue collection is improving after falling during the pandemic and riots. Income tax revenues are expected to improve in 2025 as labour force participation increases and more businesses return to profitability. Tax reform continues to be a priority, and Government intends to build on the successful implementation of the Tax Administration Act so that revenue collection agencies can operate more effectively. The Government is also committed to timely passage of the bill that will introduce a Value Added Tax and allow for it to be implemented in time to commence in 2026.

The Government is committed to strengthening public financial management and improving transparency. It not only agreed to the audit of its Economic Stimulus Package for the Covid 19 pandemic, but has subsequently published the audit report, and undertaken to address the weaknesses in transparency and accountability that the report identified. The Government has also agreed to an audit of the spending associated with the Pacific Games. While there is currently limited capacity to undertake audits and implement their findings, the Government is exploring options to enhance capability through legislation and training.

Monetary and financial markets

The authorities agree with staff that the accommodative monetary policy stance remains appropriate. The CBSI will next review the monetary stance in March 2025 and is closely monitoring developments domestically and internationally. CBSI is working in close partnership with the IMF to strengthen its audit function, risk management, and conflict of interest policies, in line with the Safeguards Assessment recommendations. CBSI recently updated the currency basket for Solomon Islands foreign exchange rate management to better reflect the weight of its major trading partners. CBSI agree with the need to periodically review the currency weights and ensure timely and transparent communication with markets when updates are made.

Solomon Islands' financial system remains sturdy despite the economically challenging environment. Banking sector liquidity is estimated to remain ample to meet short to medium-term liabilities, however, elevated levels of non-performing loans may give rise to asset quality concerns. The superannuation and insurance sectors demonstrated strong financial performances. The credit union sector overall remained stable, however, within the sector some small to medium unions are facing financial difficulties and liquidity issues. The main concern for the sector overall arises from the ongoing de-risking trend where many correspondent banking relationships (CBRs) of Pacific Island countries, including the Solomon Islands, are at risk of being terminated. The CBSI is committed to enhancing compliance with international standards, strengthening its cyber governance framework, and enhancing capacity for anti-money laundering and combating the financing of terrorism.

Structural reform

As a small and fragile state, the path for development for Solomon Islands is not straightforward. The Government recognizes that the private sector needs a more transparent environment, with reliable infrastructure, to expand. Output is heavily weighted to extractive activities such as logging, mining and fishing. There is a relatively large informal share to the economy, and the formal economy is concentrated in the capital Honiara. The theme for the 2025 Budget, which is the first budget for the Government for National Unity and Transformation that formed following the April 2024 elections, is *Accelerating Transformative Investment: A Pathway Towards a Resilient and Sustainable Economy*. The 2025 Budget is built on the twin pillars of: increasing investments in key infrastructure, promoting economic diversification and transformational economic growth; and strengthening and improving service delivery to its people.

The Government has announced it will establish a second tuna processing plant at Bina Harbour, which will create additional jobs and increase economic benefits outside of Honiara. In addition, spending will be targeted to deliver training and materials needed to lift the export capability of the rural economy with respect to cocoa, coconut and casava, and to improve import substitution and food security with respect to poultry and pigs. Tourism is underdeveloped and has potential to significantly drive economic activity. The Government will allocate spending for tourism development to support tourism operators and development facilities, and to support the National Tourism Product Program. Infrastructure investments will go towards roads and wharves to improve inter-island connectivity and the timely transportation of goods and services.