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**Solomon Island:** Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

May 14, 2010

# SOLOMON ISLANDS: LETTER OF INTENT

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, DC 20431

May 14, 2010

Dear Mr. Strauss-Kahn:

The Solomon Islands has been affected since late 2008 by the adverse impact of the global economic crisis and a terminal decline in logging output. By our estimates, economic activity contracted in 2009. Inflation declined on falling international fuel and food prices, but also due to weak demand conditions. Reflecting favorable official inflows and the IMF's SDR allocations, our foreign reserves rose, but the situation going forward is uncertain, owing to still challenging global conditions and a fragile recovery at home.

In order to better safeguard our economy against shocks, the Government of Solomon Islands has formulated a set of reforms designed to bolster the fiscal position, maintain a low level of inflation and comfortable level of foreign reserves, and strengthen the financial sector. To help achieve these objectives, we are requesting access to IMF resources under a Standby Credit Facility (SCF) for SDR 12.48 million (equivalent of 120 percent quota) for a period of 18 months. The Government will also secure support from other international financial institutions and bilateral donors.

The attached Memorandum of Economic and Financial Policies (MEFP) describes the Government's policies and objectives during 2010–11, which we believe will put our economy on a path of sustainable and more equitable growth and help advance our poverty alleviation goals. To ensure strong performance under a SCF-supported arrangement, the government will maintain a close policy dialogue with the IMF and pursue technical assistance, as necessary, from the Fund and other development partners in support of our reform agenda. We stand ready to take additional measures, as appropriate, to ensure the achievement of the government's social and economic objectives under the SCF. In keeping with this, we will consult with the IMF on the adoption of measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such matters. Moreover, we will provide the Fund with information in connection with our progress in implementing the policies and achieving the objectives of the program. We also authorize publication of the attached MEFP.

Sincerely yours,

/s/

Hon. Francis Billy Hilly, MP
**Minister of Finance and Treasury**
Ministry of Finance and Treasury

/s/

Denton Rawara
**Governor**
Central Bank of Solomon Islands

Attachments: Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding

**SOLOMON ISLANDS: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES**

*This memorandum sets forth economic and financial policies and objectives of the Government of the Solomon Islands for the period 2010–11. Under a requested Standby Credit Facility (SCF) arrangement, the government seeks to strengthen macroeconomic management and reduce underlying fiscal and external imbalances. The objective of our program is to build a path back to strong, sustainable, and equitable growth with low inflation, providing a sound basis to advance our poverty alleviation efforts. Its core elements are to strengthen government finance, improve monetary operations, safeguard international reserves, and contain financial sector risks. Quantitative targets and structural policies underlying our program are summarized in Tables 1 and 2. The first and second reviews are expected to be completed no later than November 25, 2010 and May 25, 2011, respectively.*

## I. MACROECONOMIC OUTLOOK

1. **Economic performance weakened in 2009, due to adverse global conditions and a logging output decline.** Our preliminary estimates indicate real GDP declined by 2¼ percent. Inflation pressures eased with falling fuel and food prices. Given sluggish domestic demand, bank credit contracted. Reflecting a weak external environment, the current account deficit widened to 21 percent of GDP in 2009. However, given strong official inflows, sizable reinvested earnings, and the SDR allocations, official reserves rose by more than half in 2009 to US$146 million at year end (4 months of next year's imports).

2. **The government's weak cash position and implementation capacity limited its fiscal policy response to the slowdown in 2009.** Based on the latest estimates, a budget surplus equivalent of 2¼ percent of GDP was generated in 2009. Despite the fact that we managed to increase our revenue effort through concerted tax and compliance measures, fiscal revenue fell far short of the budgeted target owing largely to the weak economy. In response, outstanding payment orders were periodically delayed to conserve cash and recurrent spending cuts had to be made. However, our gross cash balance further tightened, ending 2009 at around SI$106 million (3 to 4 weeks of recurrent spending).

3. **Macroeconomic conditions are expected to remain challenging in 2010 and 2011.** Growth is projected to rise to 3½ percent in 2010, in line with the global recovery envisaged in the IMF's latest *World Economic Outlook*, boosting agricultural and fish output. The more stable conditions and the government's liberalization efforts are also expected to bring in new mining and telecommunications investment. However, further declines in logging production will continue to act as a drag on activity. The current account deficit is projected to remain large in 2010 and 2011, in part owing to import requirements associated with foreign direct investment, although we expect medium-term prospects to improve with new gold exports starting in 2012. Under this baseline and assuming sizable exceptional financing, we expect foreign reserves to rise to around US$168 million by end-2010 and US$187 million by end-2011 (5¼ months of next year's imports).

4. **We recognize this outlook is subject to considerable uncertainty, necessitating sound policy execution to entrench macroeconomic stability**. Unexpected changes in oil and

food prices could pass through to inflation and affect the external position. Growth prospects in 2010 and 2011, in particular those related to commodity exports, hinge on the pace of the global economic recovery. In view of this, we recognize the necessity of broad ranging reforms to improve external competitiveness, boost donor and investor confidence, and achieve higher sustained growth.

## II. Program Policies

5. **Our policies are aimed at maintaining stable macroeconomic conditions, in support of achieving higher sustained growth and advancing poverty alleviation efforts**. In our view, macroeconomic stability is necessary condition for improving the business climate, attracting new investment, including in non-resource sectors, and providing more labor-intensive productive opportunities, all of which are essential to increasing growth. To these ends, the policy framework under our program also seeks to ensure adequate government funding is available for key human development outlays, consistent with improving the quality and availability of education and health services consistent with the Millennium Development Goals.

### A. Fiscal Policy

6. **The government has taken steps to strengthen fiscal operations, but sound budget execution requires better revenue administration, cash management, and expenditure prioritization.** Through the lead of the Ministry of Finance and Treasury (MoFT), we have substantially enhanced our ability to collect revenue, through both tax and administrative measures. With better enforcement, more space should be created to meet social and development needs. Over the near term, given limited capacity to borrow, our ability to fund the budget will continue to depend on available cash resources, including from recurrent budget support. We recognize immediate fiscal measures are needed to reconstitute cash balances, normalize fiscal operations, and put the Solomon Islands on a more sustainable fiscal path.

7. **In this regard, our key fiscal objectives are to:**

- Address immediate pressures on the cash balance without resorting to delaying payments to creditors or non-prioritized spending reservations;
- Build up a cash reserve fund of around two months of forward recurrent spending by end-2011 to cover the cyclicality in revenue and expenditure flows, potential contingent liabilities, and large shocks necessitating government resources; and
- Provide a lasting framework for ensuring sound budget formulation and implementation, recognizing the strong positive role that potential mining-related revenues may play if managed properly.

We recognize that achieving these objectives will require a fundamental change to our budget strategy and management, in particular as the government assumes a greater responsibility over the medium term for meeting its development and security. To this end, we will take decisive steps on our structural fiscal reform agenda, as envisaged below and in line with support from other development partners—most notably the Regional Assistance Mission for Solomon Islands, the Asian Development Bank, and World Bank Group.

8. **We are taking strong upfront actions to alleviate cash pressures.** A rolling three-month forward cash forecast for the government's recurrent and development budget has been developed by the MoFT, suggesting significant cash pressures in the near term as revenue is now expected to be weaker than in the 2010 Budget as the economic recovery this year is driven mainly by low-taxed sectors. Consistent with our forecasts, we have taken tough decisions. In the revenue area, we expect new measures to yield at least SI$24 million (0.4 percent of GDP) in 2010.

- Specifically, we have raised the determined price of logs from US$77 to US$83 per cubic meter effective April 1, 2010. In addition, we will introduce an automatic adjustment mechanism for the determined price of logs by end-September 2010, with the determined price adjusted to no less than 85 percent of the formula-based price from October 1, 2010 and with a quarterly phase-in thereafter to achieve the full formula-based price from July 1, 2011. This will align the taxable price more closely with world market prices, enhance revenue collections, and improve overall transparency. In total, we expect these measures will yield SI$14 million in additional revenue in 2010.

- We have also strengthened customs enforcement at the wharf and improved compliance through post-clearance audits, supported by the reintroduction of a special customs cargo inspection task force in May 2010 and planned appointment of a Customs Deputy Comptroller. Under these circumstances, we expect a further boost in revenues from last year's hike in excises on beer and tobacco products and new excises on wine and spirits as well increased import duties on personal and luxury vehicles by SI$10 million in 2010, based on performance so far this year.

- Further revenue gains are expected to accrue in the areas of taxpayer registration and audits, while applying successively stronger enforcement actions to collect tax arrears, including, where appropriate, by suspending import licenses and by seizing bank deposits of delinquent taxpayers.

On the expenditure side, we are restraining and reprioritizing outlays in 2010.

- We expect the biggest savings will come from line-item withdrawals of warrants, yielding net savings of at least SI$116 million (2 percent of GDP). This move will still protect priority programs—especially those funded through education and health-related budget support.

- To prevent the emergence of additional spending pressures, we have issued a ministerial circular indicating contingency warrants in 2010 will be fully funded by line-item adjustments to ministerial appropriations or additional revenue measures. As a further measure, we intend to cap the government wage bill at SI$515 million in 2010 and will incorporate all line ministries and employees into the new payroll accounting system by year end to improve accountability and control.

9. **We also realize that further concentrated efforts are needed to further strengthen revenue policy and improve tax compliance.** We will issue a ministerial circular authorizing annual notification to the Public Accounts Committee of the nature and cost of all tax and customs exemptions granted by end-June 2010. In addition, we will submit to Parliament by end-2010 a set of amendments to the Customs and Excise and Income Tax Acts legalizing exemption criteria and guidelines, including full disclosure requirements, and merging existing exemption committees into a unified committee structure, with the aim of creating a transparent process for granting exemptions. To better capture the actual transaction value of imports, we will amend the new Customs Valuation Act and issue new implementation guidelines by end-2010, bringing the act into full effect by then.

10. **With these measures, those committed under other donor programs, and through additional budget support, we will build up a cash buffer the next few years.** We will target an overall surplus of around 2½ percent of GDP in 2010, to replenish our program cash reserves by SI$120 million this year, if necessary through a supplemental appropriation. A further SI$60 million will be added in 2011 through the annual budget appropriation. The establishment of these reserves and putting the Solomon Islands on a more sustainable fiscal path would send a strong signal to potential new creditors, as we require new sources of funding in the coming years to address growth-critical infrastructure needs and expand the production and employment base.

11. **We have invited the World Bank to work closely with us on a Public Expenditure Review (PER) later this year.** This exercise will guide our reforms in reorienting expenditure to priority areas. As part of the PER, we plan to develop a better mechanism to track social and other priority spending in order to strengthen monitor the budget's impact on poverty alleviation efforts. Better execution and targeting of the government's own development budget will also require that budget allocations be aligned with spending priorities, notably those set forth in the planned update of the Medium-Term Development Strategy and under the leadership of the Ministry of Development Planning and Aid Coordination. Ongoing efforts to strengthen operational, commercial, and financial performance of state-owned enterprises, with donor support, should minimize potential fiscal risks and assist in settling cross-debts, curtailing the need for government funds.

12. **To maintain budget discipline on a sustained basis, we intend to put on place a stronger budgetary and institutional framework that guarantees sound fiscal management for this and future governments.** We will draft fiscal responsibility provisions into a Fiscal Responsibility Act or amended Public Finance and Audit Act by end-June 2011. Key provisions would be requirements to update revenue estimates with each supplemental appropriation, to ensure all appropriations are fully funded, and to preserve a cash reserve. The future looks bright with the prospects of mining projects coming on stream in around early 2012. For the people of the Solomon Islands to derive lasting benefits from our natural

resources, we will adopt a resource tax regime consistent with IMF recommendations by end-June 2011, and, as appropriate, consider subscribing to the Extractive Industries Transparency Initiative.

### B. Monetary and Exchange Rate Policy

13. **In light of weak growth momentum and low inflation pressures, we will pursue a moderately accommodative monetary policy.** However, the CBSI will continue to monitor inflation and reserves developments carefully and be prepared to tighten monetary policy, as necessary. Monetary targets have been set that provide adequate space to accommodate moderate private sector credit growth over the program period. Given the current *de facto* peg of the Solomon Islands dollar to the U.S. dollar, fiscal policy will continue to play an essential role in maintaining macroeconomic stability. In this regard, we will ensure net credit to the government and net domestic assets of the Central Bank of Solomon Islands (CBSI) are appropriately restrained.

14. **Building on recent progress, we will take further steps to strengthen our operational framework and introduce new instruments for conducting monetary policy.** The CBSI continues to refine its liquidity forecasting framework, which was introduced in 2009, to better manage short-term liquidity conditions and develop operational targets to ensure long-term price stability. Further development of our capacity to conduct monetary policy will be critical to managing the expansion of the banking system, including interbank activity, as the economy expands and diversifies.

15. **To this end, the CBSI is formulating new regulations aimed at improving banks' capacity at liquidity management and responsiveness to monetary operations**. Over the program period, we will replace the current liquid asset requirement with a required reserve system, introduce new overnight facilities, and issue short-term bills. We will clarify lender of last resort provisions by issuing new central bank executive regulations by end-June 2010 and finalize an issuance plan for shorter maturity CBSI bills by end-December 2010, if necessary with further IMF technical assistance.

16. **We will take necessary actions to maintain an adequate level of foreign reserves, in light of the Solomon Islands's vulnerability to shocks.** Given recent improvements to the external position, pressure on the exchange rate has eased. While the exchange rate provides a measure of stability as a nominal anchor, greater exchange rate flexibility will be pursued, as necessary, to help achieve the program's target on net international reserves (NIR). In the event that NIR falls by more than US$15 million during the previous 30 days, we will consult with IMF staff on the appropriate policy response.

### C. Financial Sector Issues

17. **We remain committed to maintaining a healthy financial system by strengthening CBSI oversight and implementing new prudential regulations.** Despite the economic downturn, banks are currently well-capitalized and maintain adequate liquidity. However, we

will continue to carefully monitor them in view of the recent deterioration in asset quality. We have implemented a new set of regulations aimed at strengthening the prudential requirements for commercial banks and other depository corporations, which, with technical assistance, will be extended to other financial corporations. These regulations have tightened requirements on capital adequacy, asset classification, and loan loss provisioning. The CBSI will also begin publishing financial soundness indicators.

18. **As the country's primary savings vehicle, we intend to strengthen oversight of the National Provident Fund (NPF) and better protect the independence of its operations.** With further technical assistance, we will submit a revised NPF Act to Cabinet by end-2010 clarifying the CBSI's supervisory responsibilities, the provident fund's investment mandate, and its obligations to member contributors to safeguard long-term financial viability. We will ensure any social role envisaged for the NPF does not undermine the sound management of its assets.

## III. Other Issues

19. **External debt and arrears:** We continue to implement the action plan of the Honiara Club Agreement with its signatories. Going forward, our debt management strategy will be consistent with maintaining a low level of external and public indebtedness. External arrears have been resolved with private creditors. Outstanding arrears with official creditors, now exclusively with the European Investment Bank (US$3 million) will be cleared this year.

20. **Safeguards Assessments:** We agree to ensure completion of the IMF's safeguards assessment by the time of the first review of the SCF Arrangement. The CBSI will provide Fund staff with all necessary information for the assessment.

**21. Statistical issues:** We recognize that macroeconomic statistics require further strengthening in order to establish well defined targets and objectives and ultimately to monitor outcomes and performance. Our priorities remain to strengthen the reporting of government finance statistics, in view of the public sector's size relative the rest of the economy, and compilation of national income accounts, to develop a purposeful measure of basic economic performance.

22. **Technical assistance:** We have identified a number of technical assistance and capacity building needs that are critical for our reform agenda, where we will look for the IMF and other development partners for continued support. Envisaged IMF technical assistance, including from the Pacific Financial and Technical Assistance Center, would focus on (i) further strengthening monetary management and prudential requirements; (ii) assessing revenue policy and developing a resource tax regime; (iii) supporting public financial management reforms, including through contributing to the PER, and entrenching fiscal responsibility into our legal framework; and (v) improving data compilation and reporting in key statistical areas.

## Table 1. Solomon Islands: Quantitative Performance Criteria (PC) and Indicative Targets (IT)

| | 12/31/2009 | 6/30/2010 | 9/30/2010 | 12/31/2010 | 3/31/2011 |
|---|---|---|---|---|---|
| | Est. | PC | IT | PC | IT |
| Performance criteria 1/ | | | | | |
| Net international reserves (NIR) of the Central Bank of Solomon Islands (CBSI) (floor, eop stock, in millions of U.S. dollars (US$)) 2/ | 146 | 147 | 141 | 158 | 160 |
| Net domestic asset (NDA) of the CBSI (ceiling, eop stock, in millions of Solomon Islands dollars (SI$)) 3/ | -367 | -332 | -327 | -472 | -447 |
| Net credit to central government (NCG) (ceiling, cumulative change from the beginning of the year, in millions of SI$) 4/ | -77 | 40 | 22 | -102 | 31 |
| New nonconcessional external debt maturing in more than one year, contracted or guaranteed by the public sector (ceiling, eop stock since the beginning of the program, in millions of US$) 5/ | … | 0 | 0 | 0 | 0 |
| New nonconcessional external debt maturing in one year or less, contracted or guaranteed by the public sector (ceiling, eop stock since the beginning of the program, in millions of US$) 5/ | … | 0 | 0 | 0 | 0 |
| Accumulation of new external payment arrears by the public sector (ceiling, eop stock since the beginning of the program, in millions of SI$) 5/ | … | 0 | 0 | 0 | 0 |
| Central government program cash balance (floor, cumulative change from the beginning of the year, in millions of SI$) 4/ | … | -37 | -13 | 120 | -33 |
| Memorandum item: | | | | | |
| Budget support from bilateral and multilateral donors other than IMF (cumulative change from the beginning of the year, in millions of US$), program level. | 28 | 17 | 24 | 53 | 8 |

1/ Evaluated at the program exchange rate.

2/ The adjustors are specified in the Technical Memorandum of Understanding (TMU) and include: the floor on NIR will be adjusted upward (downward) by the amount of budget support from bilateral and multilateral donors (excluding IMF) in excess (short) of the program level.

3/ The adjustors are specified in the TMU and include: the ceilings on NDA will be adjusted downward (upward) by the amount of budget support from bilateral and multilateral donors (excluding the IMF) in excess (short) of the program level.

4/ The adjustors are specified in the TMU and include: the floor on central government program cash balance will be adjusted downward and the ceiling on NCG will be adjusted upward by the amount of budget support from bilateral and multilateral donors (excluding the IMF) short of the program level.

5/ These performance criteria are applicable on a continuous basis.

### Table 2. Solomon Islands: Prior Actions and Structural Benchmarks

| Actions | Date | Macroeconomic criticality |
|---|---|---|
| ***Prior Actions*** | | |
| Develop a rolling three-month forward cash forecast for the government's recurrent and development budget. | | To strengthen budget execution and fiscal mangement. |
| Withdraw spending warrants equivalent to at least SI$116 million. | | To normilize fiscal operations and achieve fiscal targets. |
| Issue a ministerial circular indicating contingency warrants in 2010 will be fully funded by line-item adjustments to ministerial appropriations and/or new revenue measures. | | To avoid spending overruns and achieve fiscal targets. |
| ***Structural Benchmarks*** | | |
| Apply full enforcement actions to collect income tax arrears. | Continuous | To strengthen revenue administration and collections. |
| Issue a ministerial circular authorizing annual notification to the Public Accounts Committee of the nature and cost of all tax and customs exemptions granted. | June 30, 2010 | To promote fiscal transparency and enhance revenue collections. |
| Issue monetary policy regulations revising the lender of last resort provisions of the Central Bank of Solomon Islands (CBSI). | June 30, 2010 | To safeguard the stability of the financial sector. |
| Adopt an automatic adjustment mechanism for the price of logs, with the determined price adjusted to no less than 85 percent of the formula-based price from October 1, 2010, and a quarterly phase-in thereafter to achieve full consistency with the formula-based price from July 1, 2011. | September 30, 2010 | To promote fiscal transparency, enhance revenue collections, and ensure sustained output. |
| Amend the Customs Valuation Act and issue new implementation guidelines by end-2010, bringing the act into full effect. | December 31, 2010 | To strengthen customs administration and revenue collections. |
| Submit to Parliament a set of amendments to the Customs and Excise and Income Tax Acts legalizing exemption criteria and guidelines, including full disclosure requirements, and merging existing exemption committees into a unified committee structure. | December 31, 2010 | To promote fiscal transparency and enhance the efficiency of revenue collections. |
| Incorporate all line ministries and employees into the new payroll accounting system. | December 31, 2010 | To strengthen expenditure oversight and control. |
| Finalize an issuance plan for CBSI bills. | December 31, 2010 | To broaden monetary instruments. |
| Submission to the Cabinet of a revised National Provident Fund Act strengthening independence and oversight. | December 31, 2010 | To improve the long-term financial viability and reduce fiscal risks. |
| Formulate a resource tax regime, consistent with IMF technical assistance recommendations. | June 30, 2011 | To broaden the tax base and increase revenue transparency. |
| Draft fiscal responsibility provisions to be incorporated into either a Fiscal Responsibility Act or an amended Public Finance and Audit Act. | June 30, 2011 | To strengthen budget management and ensure fiscal sustainability. |

## SOLOMON ISLANDS: TECHNICAL MEMORANDUM OF UNDERSTANDING

1. The program will be monitored through quantitative performance criteria, indicative targets, structural benchmarks, and reviews. This memorandum sets out the definitions for quantitative performance criteria and indicative targets under which performance under the program will be assessed. Monitoring procedures and reporting requirements are also specified.

### I. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS

2. Performance criteria for end-June 2010 and end-December 2010 and indicative targets for end-September 2010, and end-March 2011 have been established with respect to:

- Floors on the level of net international reserves (NIR) of the Central Bank of Solomon Islands (CBSI);
- Ceilings on the level of net domestic assets (NDA) of the CBSI;
- Ceilings on the level of net credit to the central government (NCG);
- Floors on the central government cash balance.

3. Performance criteria applicable on a continuous basis have been established with respect to:

- Ceilings on the contracting and guaranteeing by the public sector of new medium- and long-term nonconcessional external debt;
- Ceilings on the contracting and guaranteeing by the public sector of new short-term nonconcessional external debt;
- Ceilings on accumulation of new external payment arrears by the public sector.

### II. INSTITUTIONAL DEFINITIONS

4. The central government includes all units of budgetary central government and extrabudgetary funds.

5. Depository corporations (DCs) include the CBSI and other depository corporations (ODCs). ODCs include commercial banks, the Credit Corporation of Solomon Islands, and credit unions. Financial corporations include DCs and other financial corporations (OFCs). OFCs are the National Provident Fund (NPF), the Development Bank of Solomon Islands, and the Investment Corporation of Solomon Islands.

## III. Monetary Aggregates

6. **Valuation**. Foreign currency-denominated accounts will be valued in Solomon Islands dollar (SI$) at the program exchange rate of SI$8.06 per U.S. dollar, as of end-2009. Foreign currency accounts denominated in currencies other than the U.S. dollar and monetary gold will first be valued in U.S. dollars at actual exchange rates and gold prices used by the CBSI, respectively, before they are converted to Solomon Island dollars.

### A. Reserve Money

7. Reserve money consists of currency issued by the CBSI (excluding CBSI holdings of currency) and all transferable deposits held at the CBSI.

### B. Net International Reserves of the CBSI

8. A floor applies to the level of NIR of the CBSI. The floor on NIR will be adjusted upward (downward) by the amount of budget support from bilateral and multilateral donors (excluding IMF) in excess (short) of the programmed level.

9. NIR will be calculated as gross international reserves (GIR) less international reserve liabilities. For program monitoring purposes, the stock of foreign assets and foreign liabilities of the CBSI, as reported in Solomon Islands dollars, shall be valued at program exchange rate in U.S. dollars, as described on paragraph 6.

10. GIR of the CBSI are defined as the sum of:

- Foreign currency assets in convertible currencies held abroad and as vault cash that are under the direct and effective control of the CBSI and readily available for intervention in the foreign exchange market or the direct financing of balance of payments imbalances and are of investment grade or held with an investment-grade institution.
- The reserve position of the Solomon Islands in the IMF; and
- Holding of SDRs; and
- Monetary gold.

Excluded from the definition of GIR are:

- Foreign currency deposits of ODCs and OFCs held at the CBSI;
- Any foreign currency claims on residents, capital subscriptions in international institutions, and foreign currency assets in nonconvertible currencies, and;

- GIR that are in any way encumbered or pledged, including, but not limited to, reserve assets used as collateral or guarantee for third-party external liabilities.

11. International reserve liabilities of the CBSI are defined as the sum of:

- All outstanding liabilities of the Solomon Islands to the IMF, excluding IMF SDR allocations; and

- Foreign currency liabilities in convertible currencies to nonresidents with an original maturity of up to and including one year

### C. Net Domestic Assets of the CBSI

12. A ceiling applies to the level of NDA of the CBSI. The ceiling on NDA will be adjusted downward (upward) by the amount of budget support from bilateral and multilateral donors (excluding IMF) in excess (short) of the programmed level.

13. NDA of the CBSI will be calculated as the difference between reserve money and the sum of NIR of the CBSI and other NFA of the CBSI. Other NFA of the CBSI includes:

- Foreign assets related to holdings of foreign currency deposits, and securities not included in NIR of the CBSI, and loans, shares, financial derivatives, or accounts receivable with nonresidents; and other foreign assets that are not included in NIR of the CBSI, as defined in Section III. B; and

- Foreign liabilities related to IMF SDR allocations; deposits, securities, loans, financial derivatives, and other accounts payable with nonresidents; and other foreign liabilities that are not included in NIR of the CBSI, as defined in Section III. B.

### D. Net Credit to the Central Government

14. A ceiling applies to the NCG measured cumulatively from the beginning of the year. The ceiling on NCG will be adjusted upward by the amount of budget support from bilateral and multilateral donors (excluding IMF) short of the programmed level.

15. NCG is defined as the sum of net claims of (i) the CBSI, (ii) commercial banks and other ODCs, and (iii) OFCs.

## IV. FISCAL AGGREGATES

### A. Cash Balance of the Central Governm3ent

16. A floor applies to the program cash balance of the central government. The floor on the program cash balance will be adjusted downward by the amount of budget support from bilateral and multilateral donors (excluding IMF) in short of the programmed level.

17. The program cash balance of the central government is defined as the gross cash balance minus the total amount of unpaid payment orders and unpresented checks.

18. The gross cash balance is defined as the sum of government deposits in the following accounts:

- In CBSI: Solomon Islands Government (SIG) Revenue Account, SIG Funded Development Account, SIG Debt Servicing Account;
- In Australia New Zealand Bank: SIG Creditors Account and Payroll Imprest Account;
- In Bank of South Pacific: Provincial Revenue Holding Account, SIG Inland Revenue Account, Sub Treasury Gizo Account, and Sub Treasury Auki Account; and,
- Other accounts that are created and under control of the government.

## V. External Debt

### A. Medium- and Long-Term External Debt

19. A ceiling applies to the contracting and guaranteeing by the public sector of new nonconcessional borrowing with nonresidents with original maturities of more than one year. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. This applies to private debt for which official guarantees have been extended and which, therefore, constitutes a contingent liability of the public sector. The public sector comprises the central government, the CBSI, nonfinancial public enterprises, and other official entities.

20. The definition of debt, for the purposes of the program, is set out in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangement Executive Board Decision No. 6230-(79/140), as revised on August 31, 2009 (see Annex I).

21. Excluded from the ceiling are (i) the use of Fund resources; (ii) lending from the World Bank and the Asian Development Bank; (iii) debts incurred to restructure, refinance, or prepay existing debts, to the extent that such debt is incurred on more favorable terms than the existing debt and up to the amount of the actually restructured/refinanced/prepaid debt; (iv) concessional debts; (v) any SI$-denominated treasury bill and bond holdings and Bokolo bonds held by nonresidents.

22. For program purposes, the guarantee of a debt arises from any explicit legal obligation of the central government, the CBSI, nonfinancial public enterprises, or other official entities on behalf of the central government or the CBSI to service debt in the event of nonpayment by the main obligor (involving payments in cash or in kind).

23. For program purposes, a debt is concessional if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the net present value (NPV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The NPV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the currency specific commercial interest reference rates (CIRRs), published by the Organization for Economic Cooperation Development (OECD). For debt with a maturity of at least 15 years, the ten-year-average CIRR will be used to calculate the NPV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the six-month average CIRR will be used. To both the ten-year and six-month averages, the same margins for differing repayment periods as those used by the OECD would continue to be added (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more).

### B. Short-Term External Debt

24. A ceiling applies to the contracting and guaranteeing by the public sector of new nonconcessional borrowing with nonresidents with original maturities of up to and including one year. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. This applies to private debt for which official guarantees have been extended and which, therefore, constitute a contingent liability of the public sector.

25. For program purposes, the definition of debt is set out in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangement approved by the Executive Board Decision No. 6230-(79/140), as revised on August 31, 2009 (see Annex I).

26. Excluded from the ceiling are (i) debts classified as international reserve liabilities of the CBSI; (ii) debts incurred to restructure, refinance, or prepay existing debts, to the extent that such debt is incurred on more favorable terms than the existing debt and up to the amount of the actually restructured/refinanced/prepaid debt; (iii) SI$-denominated treasury bills and bonds and CBSI and Bokolo bills held by nonresidents; and (iv) normal import financing. A financing arrangement for imports is considered to be "normal" when the credit is self-liquidating.

## VI. External Payment Arrears

27. A continuous performance criterion applies to the nonaccumulation of external payments arrears by the public sector, comprising the central government, the CBSI, nonfinancial public enterprises, and other official entities. External payments arrears consist of external debt-service obligations (principal and interest) that have not been paid at the time they are due, as specified in the contractual agreements.

## VII. Data Provision

28. The data listed below will be provided for monitoring performance under the program based on data templates agreed with Fund staff. Under each section, reporting responsibilities are indicated in parentheses. Weekly data are requested for submission to Fund staff by the end of the following week. Monthly and quarterly data are requested for submission within six weeks of the end of the observation period. The authorities have committed to using the best available data, so that any subsequent data revisions will not lead to a breach of quantitative performance criteria or benchmarks. All revisions to data will be promptly reported to Fund staff.

### A. Monetary Data (CBSI)

On a weekly basis:

- Daily exchange rates, both buying and selling rates, of the Solomon Islands dollar against the U.S. dollar, including the official, interbank, and parallel market exchange rates.
- Stock of NIR and sales and purchases by the CBSI in the foreign exchange markets.
- Stock of reserve money and its components.

On a monthly basis:

- Financial corporations' survey, including the balance sheet of CBSI, the consolidated balance sheet of ODCs, and the consolidated balance sheet of OFCs.
- Liquid asset ratios of the commercial banks.
- Interest rates, including average interbank rate, bank deposit rates, and bank lending rates.
- A detailed breakdown of NCG from the CBSI, commercial banks and other ODCs, and OFCs.
- Foreign exchange cash-flow of the CBSI, including donor disbursements.
- Balances of each central government account specified in Section IV. A., as recorded or collected by the CBSI.

## B. Fiscal Data (Ministry of Finance and Treasury (MoFT))

On a monthly basis:

- Consolidated accounts of the central government, including detailed data on:

    - Revenue, including tax and nontax revenues, and recurrent and development grants included in the consolidated budget.

    - Recurrent expenditure, including payroll, goods and services, and other recurrent outlays, including those funded by donor support.

    - Debt service payments, classified into amortization and interest payments on (i) domestic debt, (i) external debt, (iii) domestic arrears, and (iv) external arrears.

    - Development expenditure funded by (i) central government of the Solomon Islands, and (ii) foreign grants and loans included in the consolidated budget.

- Detailed financing components of central government's accounts, classified into foreign and domestic sources.

    - Foreign financing includes (i) disbursement and amortization of project and program loans, and (ii) changes in external debt arrears, classified into principal and interest arrears.

    - Domestic financing includes (i) borrowing from and repayment to the CBSI commercial banks and other ODCs, and OFCs; (ii) changes in deposits withdrawal from commercial banks, commercial banks and other ODCs, and OFCs; and (iii) privatization receipts and changes in domestic debt arrears, classified into principal and interest arrears.

- Stock of domestic debt, including the outstanding balance of government securities, treasury bills, cash advances, and other debt instruments.

- Balances of each central government account specified in Section IV. A., as recorded by the MoFT.

- Stock of unpaid government payment orders and unpresented checks.

## C. External Sector Data (CBSI and MoFT)

On a quarterly basis:

- New external debt obligations contracted and/or guaranteed by the government of the Solomon Islands, CBSI, and other official entities, including details on the amounts, terms, and conditions of each obligation.

- Stock of outstanding external debt at end-month and disbursement, amortization, and interest payments for short-term external obligations contracted or guaranteed by the government or the CBSI by creditor in original currency and U.S. dollars.

- Stock of external debt at end-month and disbursement, amortization, and interest payments for medium- and long-term external obligations contracted or guaranteed by the government or the CBSI by creditor in original currency and U.S. dollars.

- Stock of arrears on the external debt contracted or guaranteed by the government or the CBSI by creditor in original currency and in U.S. dollars at end-month.

On a quarterly basis:

- Balance of payment data, including detailed components of current accounts and capital and financial accounts.

## D. Real Sector Data (MoFT, National Statistical Office)

On a monthly basis:

- The monthly consumer price index and a detailed breakdown by major categories of goods and services included in the consumer basket.

## ANNEX I. GUIDELINES ON PERFORMANCE CRITERIA WITH RESPECT TO FOREIGN DEBT

Excerpt from Executive Board Decision No. 6230-(79/140), as revised on August 31, 2009

9. (a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and

(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

(b) Under the definition of debt set out in point 9 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.