International Monetary Fund

Solomon Islands and the IMF

Press Release:
IMF Executive Board Completes First Review Under Standby Credit Facility Arrangement with Solomon Islands and Approves US$4.83 Million Disbursement
November 17, 2010

Country's Policy Intentions Documents

E-Mail Notification
Subscribe or Modify your subscription

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

November 1, 2010

The following item is a Letter of Intent of the government of Solomon Islands, which describes the policies that Solomon Islands intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Solomon Islands, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

SOLOMON ISLANDS: LETTER OF INTENT

November 1, 2010

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

Dear Mr. Strauss-Kahn:

The Solomon Islands has benefited from sound macroeconomic policies that underpin the Government's economic reform program, which is being supported by a Standby Credit Facility (SCF) arrangement. Economic recovery is underway, with inflation remaining low and foreign reserves rising. The fiscal position has improved and monetary conditions remain supportive. Our aim is to continue to ensure a policy framework is in place that promotes strong, sustainable, and equitable growth in a stable macroeconomic environment, helping to advance our poverty alleviation efforts.

We remain committed to implementing the program described in the May 14, 2010 Memorandum of Economic and Financial Policies (MEFP). While the thrust of our policies are as described in the MEFP, we are providing the attached Supplemental MEFP (SMEFP), which updates the near-term outlook, requests modification of end-December performance criteria to reflect recent developments, sets the end-June 2011 performance criteria, and reaffirms policy commitments for the rest of the program period. We have also made minor amendments to the attached Technical Memorandum of Understanding to strengthen program monitoring.

Given the success of the program to date and the observance of all end-June 2010 program targets, we request the completion of the first review and release the corresponding disbursement. As the expected timing of this request is earlier than originally foreseen, we are requesting a rephasing of the disbursements such that resources under the SCF be available on or after November 15, 2010, subject to successful completion of the first review. In view of this, we are also proposing that the second review of the program take place on or after May 15, 2011 and the third review on or after November 15, 2011. The program will continue to be monitored through quantitative performance criteria and indicative targets, structural benchmarks, and semi-annual reviews (see SMEFP Tables 1 and 2).

We intend to maintain a close policy dialogue with the Fund, and stand ready to take additional measures, as appropriate, to ensure the achievement of the government's macroeconomic objectives under the SCF. We will consult with the Fund in advance on the adoption of these measures or on any revisions to policies contained in the SMEFP, in accordance with the Fund's policies on such consultation. Furthermore, we will provide the Fund with any information it may request on policy implementation, as necessary to achieve program objectives. We also authorize the publication of this Letter of Intent and the attached SMEFP.

Sincerely yours,

/s/
Hon. Gordon Darcy Lilo, MP
Minister of Finance and Treasury
Ministry of Finance and Treasury

/s/
Denton Rarawa
Governor
Central Bank of Solomon Islands

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

SOLOMON ISLANDS: SUPPLEMENTAL MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

This memorandum serves as a supplement to the May 14, 2010 Memorandum of Economic and Financial Policies (MEFP), which sets out the Government of Solomon Islands reform program, as set out in the Government of Solomon Island's arrangement under the Standby Credit Facility (SCF). We reaffirm the government's commitments to achieve the main program objective of building a path back to strong, sustainable, and equitable growth in a low inflation environment, providing a sound basis to advance poverty alleviation efforts. Our program's core elements remain strengthening government finances, improving monetary operations, safeguarding international reserves, and containing financial sector risks. Updated quantitative targets and structural policies underpinning the program are summarized in Tables 1 and 2.

I. MACROECONOMIC PERFORMANCE AND OUTLOOK

1. **Macroeconomic performance has been generally favorable in 2010**. We expect growth to be around 4 percent—slightly higher than projected in the original MEFP, mainly due to log exports. Inflation has declined to the low single digits, mostly because of subdued fuel and food prices, but a modest increase is expected by end-2010 to about 3 percent (year-on-year), reflecting recent global pressures on nonoil commodity prices. The external current account deficit is now projected to be 25–26 percent of GDP in 2010, with a more favorable trade balance and larger grants disbursements than originally programmed. Combined with private inflows related to new mining and telecommunication investments, we expect gross official reserves to rise to US$210 million by end-2010 (five months of next year's imports of goods and nonfactor services).

2. **We remain cautious in our near-term outlook, given global growth is expected to moderate slightly in 2011.** Real GDP growth in the Solomon Islands is projected to rise to 7½ percent in 2011, now factoring in the resumption of gold production by mid-year but also a moderation in logging production volumes, owing to sustainability issues. Inflation is projected to be 4–5 percent over the medium term. Given new gold exports, the current account deficit should further narrow to 22–23 percent of GDP in 2011, although unexpected pressures could emerge from stronger imports depending on the overall strength and breadth of economic recovery. Under the current outlook, gross official reserves are projected to further rise to US$250 million by end-2011 (six months of imports).

II. PROGRAM POLICIES

A. Fiscal Policy

3. **Overall fiscal performance in 2010 has been broadly in line with program targets.** Total revenue collection has been on track and recurrent spending has been restrained. As a result, the government's net cash balance, adjusting for unpaid payment orders and unpresented checks, declined by SI$8 million in the first half of the year, against a programmed decrease of SI$40 million. By a broader measure of our commitment to fiscal

discipline, net credit to the central government stayed well below the program ceiling. We continue to monitor the situation closely through our three-month forward cash forecast, with cash pressures projected to ease in the fourth quarter of 2010, factoring in expected disbursement of large European Union budget support under its Vulnerability-Flex Instrument.

4. **We remain committed to sound fiscal management, focused on strengthening the overall cash position and enabling smooth budget operations.** An overall fiscal surplus of 2.4 percent of GDP (including grants) remains our target in 2010, consistent with increasing the net cash balance by a minimum of SI$120 million during the current fiscal year. In keeping with this target, we withdrew spending warrants equivalent to SI$116 million in May 2010 and temporarily reserved other expenditure warrants to conserve cash, while protecting priority outlays. In October 2010, we also raised the taxable price of log export to US$90 per cubic meter (82 percent of the formula-based price) for the period October–December 2010 and to US$98 per cubic meter for the period January–June 2011. While the price increase in October was slightly less than that committed under the program, we believe this and the planned increase in January 2011 are consistent with meeting program revenue targets. At the same time, we remain committed to developing a stable, predictable, and nondiscretionary tax regime on logging, which we plan to embody in a new natural resource tax framework under development.

5. **In response to a supplementary budget passed by Parliament in September 2010, we have taken the necessary corrective measures to ensure fiscal targets are met.** The supplement, which totaled SI$150 million (2.6 percent of GDP) compared to the original program (or SI$178 million compared to the 2010 budget), was necessitated by spending appropriations not provisioned and contingency warrants not raised in the original budget. It mainly arose from (i) an upward adjustment to payroll spending by SI$65 million compared to the program level (SI$93 million compared to the original budget), mainly due to a revised base in 2009 arising from a new financial management information system (FMIS) and payroll accounting system upgrades; and (ii) additional appropriations of SI$85 million mainly to cover higher-than-expected election costs, overseas student grants, and foreign mission construction. Offsetting measures have been taken as follows:

- Revenue increases (SI$57 million) derive mainly from overperformance of inland revenues in the first half of the year against program targets, in part because of ongoing improvements to income tax and GST administration, with about SI$50 million in additional collections expected in 2010 (including tax arrears of around SI$15 million). The rest would come from higher-than-expected export duties, namely from logging, netting out projected shortfalls in import duties and nontax revenues.

- Expenditure savings (SI$93 million) come mostly from a partial retention of temporary spending reservations made earlier this year (SI$50 million) and expected underspending of development budget (SI$29 million). However, we are still committed to increasing development spending during the program period to address social and infrastructure needs. To this end and as part of upcoming budget deliberations for FY2011, Cabinet will give consideration to making a contribution to the new National Transport Fund (NTF) as a way of ensuring funding is available for important transport infrastructure projects and to leverage additional donor funding.

6. **We are also in the process of formulating the FY2011 budget consistent with our program commitment of ensuring public finances remain on a sustainable path.** As a new government, we have defined policy priorities consistent with achieving an overall fiscal surplus of 2¼ percent of GDP in 2011. In line with this target, we will further build up government cash balances to a minimal cover of two months of forward recurrent spending by end-2011. To ensure that the 2011 budget is formulated through a fully consultative process, we intend to present it for final passage in the first quarter of next year.

- Revenue efforts will be boosted by further broadening our tax base, including through fully operationalizing a new accounts modernization system, collecting additional tax arrears, and rationalizing tax and customs exemptions. In addition, we have amended the Customs Valuation Act to clarify valuation methods, with implementation expected by year-end (a December 2010 program benchmark). Despite an unforeseen delay, we now expect to have a Deputy Customs Comptroller in place by the beginning of 2011, who will focus on enforcement. With the expected commencement of gold exports by mid-year, new export duties, Pay-As-You-Earn (PAYE) collections, and withholding taxes on dividends are expected to accrue to the budget.

- Expenditure plans will be underpinned by a budgetary process that takes into account stakeholder views, including line ministries, provincial governments, civil society, and development partners. In this context, we will follow a well-defined budget process, anchored by issuance of a ministerial circular detailing a budget calendar, as a prior action for completion of the first review of the SCF arrangement. In view of the need to reprioritize spending to meet critical social and infrastructure needs, we will limit growth in the government wage bill and parliamentary entitlements. Real spending increases, rather, will focus on donor-supported health and education outlays and high-impact capital expenditure, including those possibly emanating from the NTF.

7. **We continue to make progress in implementing structural fiscal reforms under the program.** Enforcement actions have been taken against several large taxpayers to collect income tax and customs-related arrears (a continuous program benchmark). We also are making timely progress in incorporating all line ministries into the new payroll accounting system and in legalizing exemption criteria and guidelines and merging exemption committees governed by the Customs and Excise and Income Tax Acts (December 2010 program benchmarks). Since necessary amendments to these acts cannot be submitted to Parliament until it reconvenes in early 2011, we will seek cabinet approval of them by end-December 2010. The work with the World Bank on Public Expenditure Review is ongoing, with the outcome expected to improve budget formulation and spending prioritization. We will continue our efforts to compile and report data on nonappropriated development expenditure, through inter-ministerial cooperation, and to collect and monitor priority

spending. To these ends, we intend to redouble our efforts to strengthen cash management and budget execution by incorporating a new chart of accounts into the FMIS and ascribing to International Public Sector Accounting Standard (IPSAS) cash-based accounting standards.

8. **We are also committed to taking steps to ensure long-term fiscal sustainability.** We expect ongoing IMF technical assistance will help us develop a framework for a natural resource tax regime by June 2011 (a program benchmark). Until this regime is in place, we will refrain from signing new mineral leasing agreements. Complementing this action will be efforts to push ahead with a comprehensive mining policy, with the assistance of the World Bank, which promotes the sound and transparent development of the mining sector. More broadly, we are preparing a stand-alone Public Finance Act that will incorporate fiscal responsibility provisions (a June 2011 program benchmark). Among other things, these provisions, as a complement to new financial instructions already built into the current act, would provide a description of the annual and medium-term budget strategy chosen to obtain fiscal objectives and ensure regular publication of reports on the attainment of these objectives. Finally, working with the Asian Development Bank and World Bank, we remain committed to accounts strengthening at the state-owned enterprises and annual production of audited financial statements, as a first line of defense against incurring unforeseen contingent liabilities.

B. Monetary, Exchange Rate, and Financial Sector Policies

9. **The rapid increase in international reserves and corresponding buildup in domestic liquidity continue to pose a challenge to monetary policy operations.** Given limited tools to sterilize the monetary impact of rising net international reserves (NIR), reserve money has increased rapidly since end-2009. However, we do not see signs of overheating so far, as private sector credit growth remains sluggish and banks' excess reserves continue to build at the CBSI. Nonetheless, we are fully aware that this excess liquidity might create inflationary pressures once lending activities pick up, as we expect later this year as economic recovery gains steam.

10. **We will continue to monitor monetary conditions closely, with the Central Bank of Solomon Islands (CBSI) standing ready to tighten monetary policy, as necessary.** To strengthen our liquidity management framework, we intend to issue guidelines on the auction of CBSI and treasury bills for open market operations by end-December 2010 (a program benchmark). At the same time, we will replace the current liquid asset requirement with a statutory reserve requirement, giving banks a more efficient means for managing their liquidity. We also plan to issue guidelines to introduce new standing facilities to establish an interest rate corridor to anchor monetary operations.

11. **Exchange rate policy will remain focused on maintaining an adequate level of foreign reserves while supporting the recovery in the economy.** In light of recent balance of payment developments, we are revising upward the targets for NIR to capture some of the overperformance as an added cushion for external shocks. At the same time, we will ease limits on commercial banks' overnight holding of foreign exchange and reduce the maximum exchange rate margins they are allowed to charge customers to facilitate foreign exchange

related transactions. The authorities also stand ready to bestow greater exchange rate flexibility, as necessary, to help achieve the program's target on NIR.

12. **We remain committed to enforcing new prudential regulations and strengthening financial sector soundness.** The banking sector remains well capitalized and profitable, although the application of the new prudential guidelines has indicated greater asset quality risks. To move toward a more risk-based supervisory approach, we are conducting on-site examinations of one bank by end-December 2010, and plan to extend the coverage to another by end-June 2011. In regard to the National Provident Fund (NPF), an on-site examination was conducted jointly by the CBSI and Australian Prudential Regulation Authority in September 2010. Following this important exercise, we will prepare a policy paper outlining proposed reforms to the NPF for Cabinet to endorse by end-December 2010 (a program benchmark). This paper is expected to recommend an independent governance structure for the NPF aimed at strengthening fund management and investment decisions. Following Cabinet's endorsement of the policy paper, the Attorney General's office will use it to draft the necessary amendments to the NPF Act, which we will submit to Parliament by end-June 2011 (a program benchmark).

III. Other Issues

13. **External debt and arrears:** We have initiated work on the five-year review of the Honiara Club Agreement, with assistance from the World Bank, which we aim to use to update development partners and other potential creditors on our progress in reducing debt levels and eliminating external arrears, as a step toward possible future concessional borrowing. Complementing this move is the recent "yellow light" status inferred by the World Bank's International Development Association, consistent with the medium risk of debt distress noted in the update of the Debt Sustainability Analysis done at the time of approval of the SCF arrangement.

14. **Safeguards assessment:** The CBSI is committed to implementing the recommendations of the IMF Safeguards Assessment by fully constituting the CBSI board (a new December 2010 program benchmark) and publishing annually the opinion rendered by the international audit firm on CBSI audit results and the IFRS-based financial statements, beginning with the 2010 accounts (a new June 2011 program benchmark).

15. **Statistical issues:** In view of the need to provide a broad measure of economic activity, we will publish national income accounts for 2007–09 by June 2011 (a new program benchmark).

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		6/30/2011
	Est.	Rev.	PC	PC with adjustors	Est.	IT	PC	Rev.PC	IT	Rev.IT	PC
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$)) 2/ 3/	146	146	147	155	178	141	158	201	160	206	214
Net domestic asset (NDA) of the CBSI (ceiling, eop stock, in millions of Solomon Islands dollars (SI$)) 4/ 5/	-367	-328	-332	-396	-424	-327	-472	-411	-447	-401	-411
Net credit to central government (NCG) (ceiling, cumulative change from the beginning of the year, in millions of SI$) 6/	-77	-77	40	40	-83	22	-102	-80	31	31	-14
New nonconcessional external debt maturing in more than one year, contracted or guaranteed by the public sector (ceiling, eop stock since the beginning of the program, in millions of US$) 7/	…	…	0	0	0	0	0	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$) 7/	…	…	0	0	0	0	0	0	0	0	0
Accumulation of new external payment arrears by the public sector (ceiling, eop stock since the beginning of the program, in millions of SI$) 7/	…	…	0	0	0	0	0	0	0	0	0
Central government program cash balance (floor, cumulative change from the beginning of the year, in millions of SI$) 6/	…	…	-37	-37	-8	-13	120	120	-33	-33	10
Memorandum items:											
Budget support from bilateral and multilateral donors other than IMF (cumulative change from the beginning of the year, in millions of US$), program level.	28	28	17	…	25	24	53	59	8	11	28
Outstanding stock of Solomon Islands government (SIG) treasury bills, excluding restructured government bonds (end-period stock, in millions of SI$), program level.	…	…	…	…	…	…	…	40	…	40	40

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 end-June 2010 NIR target is adjusted upward by US$7.5 million, the amount of budget support from bilateral and multilateral donors (excluding IMF) during January-June 2010 in excess of the program level.

4/ 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.

5/ The end-June NDA target is adjusted downward by SI$60.6 million, the amount of budget support from bilateral and multilateral donors (excluding IMF) during January-June 2010 in excess of the program level. Following the recommendations of the IMF Safeguards Assessment, the revised end-2009 NDA as well as the revised program targets for end-December 2010 and end-March 2011 and new targets for end-June 2011 incorporate the recommended changes in the measurement of reserve money. Such changes, however, are not applied in measuring the June 2010 NDA outcome to make it consistent with the June 2010 PC, which was set before the changes were made.

6/ 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 stock amount of budget support from bilateral and multilateral donors (excluding the IMF) short of the program level; the floor on the program cash balance will be adjusted upward (downward) by the stock of government treasury bills, excluding restructured government bonds, in excess (short) of the program level.

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

Table 2. Solomon Islands: Prior Action and Structural Benchmarks

Actions	Date	Macroeconomic criticality	Status
	Prior Action		
Issue a ministerial circular detailing the new budget calendar for 2011.		To strengthen the budgetary process.	
	Benchmarks		
Apply full enforcement actions to collect income tax arrears.	Continuous	To strengthen revenue administration and collections.	In progress, with several prosecutions under way.
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.	Met (June 25, 2010).
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.	Met (June 30, 2010).
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.	Not fully met. The price for October-December 2010 was increased from US$83 per cubic meter to US$90 (equivalent to 82 percent of the formula based price), and for January-June 2011 to US$98. The tax regime for logging is expected to be embodied in a new natural resource tax framework under development.
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.	The amendment was passed by Parliament on September 28, 2010. The full act is expected to be implemented by end-2010.
Receive cabinet approval 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.	In progress, with draft amendments under preparation by the Attorney General's office. Cabinet approval, instead of parliamentary submission, is sought by end-December 2010, since the Parliament is not expected to reconvene before early 2011.
Incorporate all line ministries and employees into the new payroll accounting system.	December 31, 2010	To strengthen expenditure oversight and control.	In progress, with teachers, the police force, and all line ministries under the establishment incorporated and a reconciliation of recorded payrolls under way.
Issue auction guidelines for CBSI and treasury bills.	December 31, 2010	To broaden monetary instruments.	The regulations are being drafted with IMF technical assistance (TA).
Constitute fully the membership of the CBSI Board of Directors.	December 31, 2010	To strengthen governance of the CBSI.	New benchmark.
Obtain Cabinet endorsement of a reform plan to the National Provident Fund (NPF) strengthening governance and oversight.	December 31, 2010	To improve the long-term financial viability of the NPF and reduce fiscal risks.	A policy paper outlining proposed reforms to the NPF is being prepared. Wider consultations with the stakeholders are being conducted to strengthen ownership of the proposed reforms.
Submit to Parliament a revised National Provident Fund (NPF) Act incorporating the reform plan endorsed by the Cabinet.	June 30, 2011	To improve the long-term financial viability of the NPF and reduce fiscal risks.	New benchmark.
Formulate a resource tax regime, consistent with IMF technical assistance recommendations.	June 30, 2011	To broaden the tax base and increase revenue transparency.	IMF TA in this area is ongoing.
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.	The Public Finance and Audit Act is being separated into two stand-alone acts, with fiscal responsibility provisions to be built into a stand-alone public finance act..
Publish finalized national income accounts for 2007-09.	June 30, 2011	To strengthen macroeconomic indicators.	New benchmark, with a technical advisor employed to assist the National Statistics Office with improving statistical policy, including on the national income accounts.
Publish the opinion rendered by the international audit firm on the CBSI audit results and the IFRS-based financial statements, beginning with the 2010 financial statements.	June 30, 2011	To improve transparency of the CBSI.	New benchmark.

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-December 2010 and end-June 2011 and indicative targets for 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); and
- 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; and
- 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 Islands 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;
- 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. Any revisions to the historical stock of reserve money based on changes to the accounting treatment of the profit/loss account of the CBSI will be notified to the Fund immediately and used to adjust monetary aggregates by an equivalent amount, as deemed appropriate. 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, (iii) OFCs, (iv) insurance companies, (v) and government treasury bills held by the general public.

IV. Fiscal Aggregates

A. Cash Balance of the Central Government

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. The floor

on the program cash balance will also be adjusted upward (downward) by the stock of government treasury bills, excluding restructured government bonds, in excess (short) of the program level of SI$40 million.

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, which are not in any way encumbered or pledged as collateral or used as a guarantee against government incurred liabilities, 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; Payroll Imprest Account, and Airport Service Fees Account;
- In Bank of South Pacific: Provincial Revenue Holding Account, SIG Inland Revenue Account, Sub Treasury Gizo Account, and Sub Treasury Auki Account; and
- Donor funded budget support accounts that are created by 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 10-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 6-month average CIRR will be used. To both the 10-year and 6-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; and
- Treasury bill auction reports.

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 and/or reserves requirement 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; and
- 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;
  - Other recurrent charges of the Ministry of Education and Ministry of Health, separating spending 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; and
  - 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.