International Monetary Fund

Solomon Islands and the IMF

Press Release:
IMF Executive Board Approves a One-Year Standby Credit Facility Arrangement for Solomon Islands
December 7, 2011

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

November 4, 2011

SOLOMON ISLANDS: LETTER OF INTENT

Ref: RF457/5/5 November 4, 2011

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Ms. Lagarde

Solomon Islands has benefited from the implementation of the government's economic reform program supported by a Standby Credit Facility (SCF) arrangement approved in June 2010. Economic recovery has been stronger than expected, the fiscal and external positions have strengthened, and donors' support has been catalyzed.

Given the observance of all end-June 2011 quantitative targets by large margin and the progress in implementing the structural benchmarks, we request the completion of the third and final review under the SCF arrangement and the release of the corresponding disbursement of SDR3.12 million.

Looking ahead, while growth momentum is expected to remain strong, downside risks to global growth have increased. We remain committed to reforms aimed at strengthening our economic resilience and promoting strong, sustainable, and inclusive growth to help advance our poverty alleviation efforts with a continued engagement with the Fund. To move toward achieving these objectives and to preserve the reform momentum, we are requesting a successor arrangement. Given the strong reserve position and program performance, we would like to request a new precautionary 12-month Standby Credit Facility (SCF) for SDR5.2 million (equivalent of 50 percent quota). We believe that this successor arrangement would help lock in the progress made so far in strengthening macroeconomic performance and economic institutions. It would be a building block in implementing an ambitious medium-term structural reform agenda which could be supported by another Fund facility in the future.

The attached Memorandum of Economic and Financial Policies (MEFP) describes the Government's reform policies during 2011–12, which we believe will strengthen our macroeconomic management framework, preserve the strong external and fiscal positions, maintain a stable monetary condition, and strengthen the financial sector. In order to ensure strong implementation under the precautionary SCF, the program will be monitored through quantitative performance criteria and indicative targets, structural benchmarks, and semi-annual reviews (see MEFP 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 precautionary SCF. We will consult with the Fund in advance on the adoption of these measures or on any revisions to policies contained in the MEFP, in accordance with the Fund's policy 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 MEFP.

Sincerely yours,

/s/	/s/
Hon. Gordon Darcy Lilo, MP	**Denton Rarawa**
Minister of Finance and Treasury	Governor
Ministry of Finance and Treasury	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 Solomon Islands for the period 2011–12 under a requested precautionary Standby Credit Facility (SCF) arrangement with the IMF.

I. RECENT DEVELOPMENTS AND OUTLOOK

1. **Macroeconomic conditions have improved remarkably.** The strong implementation of the IMF program has helped restore economic and financial stability and triggered donor support. Activity rebounded from the global financial crisis by 7 percent in 2010 and is estimated to have grown by nearly 10 percent in 2011. Logging production has been stronger than expected and gold investment supported growth in the transport, telecommunication and construction sectors. Inflation increased to 8¾ percent (year-on-year) in August 2011, partly driven by commodity prices, but there are signs of moderation on a month-on-month basis, with inflation expected to recede to 6½ percent on average in 2011. The balance of payments position has also improved substantially with gross international reserves reaching US$355 million (around 6 months of imports of goods and services) in August 2011, from less than US$100 million in mid-2009.

2. **The near- and medium-term outlook is still favorable, but challenges remain.** An uncertain global environment poses downside risks in the near term, while vulnerability to climate change could take a toll on long-term economic prospects. In the near term, real GDP growth is projected to remain healthy at around 6 percent in 2012 with gold production taking over logging as the main driver of growth. Over the medium term, logging production is expected to decline, but gold production and agriculture should continue to support growth in the range of 4 percent. Headline inflation is likely to remain around 4½ percent in the medium term as commodity prices stabilize. The balance of payments position should also remain strong with gross international reserves above 4 months of imports. Assistance from development partners is also expected to continue to support growth in the medium term. The downside risks are mainly external due to the rapidly weakening global outlook that could hit commodity prices and demand as Solomon Islands remains highly vulnerable to commodity price volatility and external demand shocks. On the upside, the outlook for logging and mining may be stronger than expected should the Asian economies remain resilient to negative spillovers from the current global financial turmoil. Over the medium term, climate change could negatively affect incomes and food security in rural areas through an increase in water salinity, especially in the outer islands.

3. **The reform program under the SCF arrangement is on track**. The program targets for end-June 2011 were met with comfortable margins. Government cash balances reached more than SI$300 million at end-June, covering two months of recurrent spending, and the net international reserves stood at US$340 million. The targets for net credit to government and the central banks' net domestic assets were also met with comfortable margins. We have also implemented most of the benchmarks committed under the program (Tables 1 and 2).

4. **Further reforms are needed to ensure that Solomon Islands reduces its vulnerability to external shocks and remains on a sustainable growth path.** Building on the success of the current program, we are formulating a set of reform policies that can be supported by a successor arrangement with the Fund.

II. Program Policies

To increase resilience to shocks we will need to rebuild our policy buffers and implement growth-oriented structural reforms which would help boost investors' confidence and ensure sustainable and inclusive growth. To this end, our program will continue to focus on strengthening fiscal management framework, improving monetary operations, maintaining a strong foreign exchange position, and containing financial sector risks. The quantitative targets and structural policies underlying our program are summarized in Tables 1 and 2.

5. **Our policies are aimed at preserving stable macroeconomic conditions to help advance our poverty alleviation efforts**. Our macroeconomic objectives include achieving growth at 6 percent in 2012 and 4 percent in the medium term. We will also seek to maintain strong domestic and external balances by preserving adequate fiscal buffers, maintaining low inflation at 4–5 percent, and building a comfortable international reserves position at more than 4 months of imports. The policy framework under our program will also ensure adequate resources for health, education, and infrastructure, which are critical to support our poverty alleviation and growth objectives in the medium-term.

A. Fiscal Policies

6. **We remain committed to preserving a strong fiscal position while providing adequate resources for health, education, and infrastructure (including water sanitation).** The fiscal position has improved over the last year as a result of strong commodity revenues and better fiscal management. The buoyancy of tax collections, over-performance in the cash balance in 2010–11, and additional mining revenue would provide an opportunity to scale-up quality spending in 2012. However, we realize that revenue will continue to remain volatile due to its dependence on commodities. Thus, we will strike a balance between preserving strong fiscal buffers and refocusing on critical infrastructure and social priority expenditure, such as health and education. To achieve this goal, we will ensure that the 2011 supplemental budget and the 2012 budget are consistent with the following policies:

- To retain an adequate fiscal buffer, we will continue to maintain the cash balance at no less than 2 months of recurrent spending.

- To improve the composition of spending and ensure sustainable and inclusive growth, the 2012 budget will shift more resources toward the social sector (health and education) and infrastructure, including water sanitation. Thus, we will maintain spending on education and health at no less than 32 percent of government-funded recurrent budget, in line with our economic reform program and consistent with the Core Economic Working Group's recommendation, and make a larger contribution (SI$100 million in 2012) to the National

Transport Fund.[1] This will help make meaningful progress toward the achievement of the MDGs, which are out of reach under current policies and alleviate poverty. We will continue to restrain growth of non-essential recurrent spending. In particular, large wage/benefits increases and transfers to local constituencies will be resisted.

- To strengthen public financial management and better monitor priority spending, we will revise our budget presentation from input line items to functional/output items by September 2012, in time for the preparation of the 2013 budget (program benchmark). We will also seek assistance from development partners to strengthen procurement and internal audit processes to reduce leakages that affect public service delivery.

- Should commodity revenue surprise on the upside, or under-spending of the development budget materialize due to capacity constraints, we will build up government saving or retire external and/or domestic debt to create fiscal space for critical spending and deal with future shocks. If we decide to retire domestic debt, we will ensure that the injection of liquidity into the private sector does not lead to excessive demand pressure on the economy. We will closely coordinate cash flow projections and plans for debt repayments between Ministry of Finance and Treasury and the Central Bank of Solomon Islands.

- We will continue to boost domestic revenue by strengthening compliance, streamlining exemptions. In July we raised the export price of logs in three equal increases (for July–September 2011, October–December 2011, and January–March 2012) to reach the full market price starting on January 1, 2012, and we will continue to apply the full market price with quarterly adjustment. We will also submit to Parliament the amendments to tax legislations to strengthen exemption rules and clarify the role of exemption committee by end-2011 (program benchmark).

- To enhance public service delivery we will reduce operational and non-technical losses to ensure cost recovery and efficiency gains in the state-owned electricity and water enterprises with the assistance of development partners. In particular, we will resolve cross arrears between the water and the electricity companies and undertake tariff reform for water charges.

7. **Over the medium term, in view of the expected decline in logging revenue and development grants, our fiscal policies will focus on strengthening the management of natural resources and securing sufficient resources for development needs**. The National Development Strategy (NDS) launched in September 2011 will form the basis for a comprehensive poverty reduction and growth strategy over the next few years. The NDS is aimed at alleviating poverty and providing greater benefits and opportunity to improve the lives of all Solomon Islanders in a peaceful and stable society. This would be done by taking better care of the people by fulfilling social needs, improving the livelihood and the economic

[1] We are still working toward reconciling the data on spending on health and education. An indicative floor on this priority spending will be set during the first program review once the tracking mechanism is in place.

benefits, and providing enabling environment to achieve development objectives. Going forward, the strategy will also include costing and prioritization of projects, and will articulate further the linkages between spending, growth and poverty reduction. Measures to boost private sector development and improve access to credit would also ensure a more broad-based growth.

- To strengthen our medium term fiscal position, we will implement a multi-year budget framework by September 2012 in time for the 2013 budget. Casting budget decisions in a multi-year perspective will help design realistic fiscal plans in line with the objectives of the NDS. It will also help build consensus on the appropriate sequencing of development projects.

- To help anchor the fiscal plans over the medium term, we will shift toward targeting the non-commodity fiscal balance as opposed to the cash balance in 2014, as mining becomes a larger source of government revenue. This will insulate the budget from the volatility of commodity revenues, help smooth expenditure over the mining cycle, and ensure a long-term sustainable use of exhaustible resources.

- Implementing a new resource taxation regime will be critical for the country to benefit from its natural resource wealth. In this context, we will seek to obtain Cabinet approval by March 2012 of draft amendments to income tax, custom and excise tax, and goods tax legislations to implement a new mining taxation regime, in line with IMF technical assistance recommendations (program benchmark). Until this new tax regime is in place, we will refrain from approving new mining leases. At the same time, we will enforce the agreements currently in place with mining companies to ensure that the government receives its share of mining revenue.

- Reforms of the mining legislations should move in parallel to provide a predictable investment regime and a transparent regulatory framework to attract foreign investment. In this context, we have also endorsed the principles of the Extractive Industry Transparency Initiative (EITI) and will move toward the EITI participation.

- Adopting fiscal responsibility provisions would help strengthen the medium-term fiscal framework. We will continue to reform the Public Finance and Audit Act (PFAA) by seeking a Cabinet approval by September 2012 of the new PFAA that incorporates fiscal responsibility provisions, management and use of public funds, and management of public debt (program benchmark).

- Resuming concessional borrowing after completing the Honiara Club Agreement (HCA) review in areas where donor grants are less available but have high economic returns such as infrastructure projects would be key. The work on formulating a new debt management strategy, by incorporating the results of the IMF-World Bank Debt Sustainability Analysis, is now ongoing. We plan to finalize the new debt strategy by end-2011 and, together with the signatories of HCA, will complete the HCA review by end-April 2012 (program benchmark), paving the way for concessional borrowing to resume by mid-2012.

- Providing a reliable and a cost-efficient source of energy is critical for private sector development, including the mining sector. To exploit our hydro power potential we will secure financing to develop the Tina River power project with the assistance of the World Bank Group. To provide wider access to renewable energy and reduce reliance on volatile imported diesel, we will promote broader use of solar power.

B. Monetary, Exchange Rate, and Financial Sector Policies

8. **Monetary and exchange rate policies will continue to be geared toward maintaining price and external stability.** Given the comfortable level of foreign reserves, the Central Bank of Solomon Islands (CBSI) let the currency appreciate by 7 percent against the US dollar from March 2011 to August 2011 to mitigate the imported inflation pressure. As a result, inflation is on a downward trend. Yet, monetary conditions have remained accommodative over the past year as a result of the improved balance of payments position, but with no signs of pickup in private credit. In view of the high level of banks' excess reserves, the CBSI has enhanced the use of the central bank Bokolo and treasury bills recently (rising to SI$ 319 million since April 2011) to mop up liquidity. The CBSI will closely monitor credit developments and tighten monetary conditions using both direct and indirect monetary instruments should banks begin to expand credit aggressively. The current exchange rate regime has provided a strong nominal anchor. Exchange rate policy will continue to be managed in a flexible manner to buffer against external shocks.

9. **To strengthen the effectiveness of CBSI in the conduct of monetary policy and supervisory activities, we are amending the CBSI Act.** The process has taken longer than envisaged as we had to seek Cabinet approval of the drafting instructions (obtained in October 2011) for the amendments. Following consultations among stakeholders, we will seek Cabinet approval of the draft Act by end-March 2012 (revised program benchmark).

10. **We will continue our efforts to strengthen the financial sector and improve access to credit.** On-site examinations of all three major banks have now been completed and they have revealed a significant overstatement of capital due to the accounting treatment of Nostro balances. The CBSI has requested the banks to undertake urgent corrective actions and to ensure that all banks are above the minimum capital requirement by end-October 2011. To facilitate large project financing, the prudential guideline on the single borrower limits will be revised by end-2011, taking into consideration the constraints posed by the small size of the banking system and the predominance of three foreign banks. The Financial Institutions Act of 1990 will also be amended to reflect structural changes in the financial system and the latest international best practices. We will request IMF technical assistance for this purpose.

11. **Reforming the National Provident Fund (NPF) to improve its governance and investment performance would be essential to provide retirement income and maintain financial stability**. The drafting instructions to the amendments to the NPF Act (September 2011 benchmark) have taken more time than envisaged due to delays in the provision of external technical assistance and the need for wider consultations among stakeholders to strengthen ownership. In this regard, we plan to seek Cabinet approval of the drafting instructions by end-June 2012 (revised program benchmark). The drafting will be guided by

the approved policy paper on NPF reforms that strengthen governance structure to reduce political influence on investment decision and maximize returns to its members.

III. Other Structural Reforms to Support Private Sector Development

12. **Reforms to support private sector development are critical for inclusive growth.** We will streamline land title registration and transfer of ownership to ease access to credit and improve collateral recovery. To encourage financial access by small enterprises we will explore options to enhance the use of the small business finance scheme administrated by the CBSI and Secured Transactions Act. To achieve these objectives, we will build on the experience of other countries and tap on resources from our development partners.

13. **Solomon Islands is vulnerable to climate change**. An adaptation and migration strategy will need to be developed with the help of development partners to mitigate the adverse impact on the most vulnerable and to fund climate change-proof infrastructure.

IV. Other Issues

14. **Safeguards assessment.** We agree to ensure the completion of the Safeguards Assessment update by the time of first review of the successor precautionary SCF arrangement. The CBSI will provide Fund staff with all necessary information for the update.

15. **Statistics.** Progress has been made in strengthening the quality of national account statistics and fiscal and monetary data for program purposes. We will continue to improve the quality of macroeconomic data by devoting more resources to the national statistics office by hiring more staff.

Table 1. Solomon Islands: Quantitative Performance Criteria (PC) and Indicative Targets (IT) for the Current and Prospective Successor Arrangement

	3/31/2011			6/30/2011			9/30/2011	12/31/2011	3/31/2012	6/30/2012	9/30/2012
	IT (CR/10/359)	IT with adjustors	Est.	PC (CR/11/180)	PC with adjustors	Est.	IT (CR/11/180)	PC	IT	PC	IT
Performance criteria 1/											
Net international reserves (NIR) of the Central Bank of Solomon Islands (CBSI) (floor, end-of-period stock, in millions of U.S. dollars (US$)) 2/	206	197	277	280	284	340	283	345	351	357	364
Net domestic asset (NDA) of the CBSI (ceiling, end-of-period stock, in millions of Solomon Islands dollars (SI$)) 3/	-401	-332	-767	-700	-731	-1199	-722	-767	-870	-869	-875
Net credit to central government (NCG) (ceiling, cumulative change from the beginning of the year, in millions of SI$) 4/	31	100	-23	17	17	-288	-15	-58	27	19	4
New nonconcessional external debt maturing in more than one year, contracted or guaranteed by the public sector (ceiling, end-of-period stock since the beginning of the program, in millions of US$) 5/	0	0	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, end-of-period stock since the beginning of the program, in millions of US$) 5/	0	0	0	0	0	0	0	0	0	0	0
Accumulation of new external payment arrears by the public sector (ceiling, end-of-period stock since the beginning of the program, in millions of SI$) 5/	0	0	0	0	0	0	0	0	0	0	0
Central government program cash balance (floor, cumulative change from the beginning of the year, in million of SI$) 4/	-33	-105	34	-30	-30	47	-8	…	…	…	…
Central government program cash balance (floor, end-of-period stock, in million of SI$) 4/	…	…	…	…	…	…	…	287	287	292	313
Memorandum items:											
Central government program cash balance (floor, end-of-period stock, in million of SI$) 4/	134	62	297	233	233	309	255	…	…	…	…
Budget support from bilateral and multilateral donors other than IMF (cumulative change from the beginning of the year, in millions of US$), program level.	11	…	2	21	…	25	39	50	14	30	44
Outstanding stock of Solomon Islands government (SIG) treasury bills, excluding restructured government bonds (end-of-period stock, in millions of SI$), program level.	40	…	38	40	…	40	40	40	60	60	60

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. Following the recommendations of the IMF Safeguards Assessment, the program targets starting from end-December 2010 incorporate the recommended changes in the measurement of reserve money. Such changes, however, are not applied in measuring the September 2010 NDA outcome to make it consistent with the September 2010 IT, which was set before the changes were made.
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 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.
5/ These performance criteria are applicable on a continuous basis.

Table 2. Solomon Islands: Structural Benchmarks

Actions	Macroeconomic criticality	Date	Status
Current Standby Credit Facility Arrangement			
Formulate a resource tax regime, consistent with IMF technical assistance (TA) recommendations.	To broaden the tax base and increase revenue transparency.	June 30, 2011	A policy paper outlining the new resource tax regime has been submitted to Cabinet, and approval was received in September (Met with delay).
Obtain Cabinet approval of a proposal to reform Public Finance and Audit Act and to incorporate fiscal responsibility provisions.	To strengthen budget management and ensure fiscal sustainability.	June 30, 2011	The proposal was submitted to Cabinet in June, and approval was received in July 2011 (Met with delay).
Publish the proposed amendments to the Public Finance and Audit Act including the draft fiscal responsibility provisions for public consultation.	To strengthen budget management and ensure fiscal sustainability.	September 30, 2011	Expected to be published in November 2011 (Expected to be met with delay).
Obtain Cabinet endorsement of the drafting instructions to revise the National Provident Fund (NPF) Act incorporating the reform plan.	To improve the long-term financial viability of the NPF and reduce fiscal risks.	September 30, 2011	In progress, but delayed due to capacity constraints. Technical assistance from donors is being sought and new completion date is set (Delayed, see below).
Publish the opinion rendered by the international audit firm on the Central Bank of Solomon Islands (CBSI) audit results and the IFRS-based financial statements, beginning with the 2010 financial statements.	To improve transparency of the CBSI.	June 30, 2011	The opinion is included in the 2010 CBSI Annual Report published in the CBSI website (Met).
Obtain Cabinet approval of draft amendment to the CBSI Act.	To strengthen the effectiveness of monetary policy.	September 30, 2011	In progress. The drafting instruction to amend the CBSI Act has been approved by the Cabinet in October, but the draft amendment is expected to be approved in March 2012 (Delayed, see below).
Publish finalized national income accounts for 2007-09.	To strengthen macroeconomic indicators.	June 30, 2011	The National Statistics Office (NSO) published the national account statistics in June 2011 (Met).
Successor Arrangement			
Submit to Parliament the amendments to the Customs and Excise and Income Tax Acts to strengthen exemption rules and clarify the role of exemption committee.	To promote fiscal transparency and enhance the efficiency of revenue collections.	December 31, 2011	
Obtain Cabinet approval of a draft amendment to income tax, customs and excise tax, and goods tax legislations related to the new mining tax regime in line with IMF TA recommendations.	To broaden the tax base and increase revenue transparency.	March 31, 2012	
Obtain Cabinet approval of draft amendment to the CBSI Act to strengthen the monetary policy and supervisory framework.	To strengthen the effectiveness of monetary policy.	March 31, 2012	
Complete the Honiara Club Agreement (HCA) review and reach agreements on amendments to the HCA.	To strengthen debt management and maintain public debt sustainability.	April 30, 2012	
Obtain Cabinet approval of the drafting instructions to revise the NPF Act incorporating the reform plan approved by the Cabinet to strengthen its governance structure and investment framework.	To improve the long-term financial viability of the NPF and reduce fiscal risks.	June 30, 2012	
Obtain Cabinet approval of the draft of new Public Finance and Audit Act that covers fiscal responsibility provisions, management and use of public funds, and management of public debt.	To strengthen budget management and ensure fiscal sustainability.	September 30, 2012	
Revise the budget presentation from input line items to functional/output line items.	To strengthen the quality and monitoring of government spending.	September 30, 2012	

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 2011 and end-June 2012 and indicative targets for end-March 2012 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 extra budgetary 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$7.42 per U.S. dollar, as of end-June 2011. 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 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 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 in 2011 and SI$60 million in 2012.

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 (i.e., enterprises in which the government owns more than 50 percent of the shares), 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 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 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 at the CBSI, 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 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 sometime 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.