

Solomon Islands

The formation of the new four-party Coalition for Change Government in May 2006 quelled the violent civil unrest that occurred in April 2006, following national elections and announcement of the initial choice of Prime Minister by the newly elected Parliament. The political situation however, remains fluid. Concurrently, a series of diplomatic rows between the Solomon Island and Australian governments has raised the possibility that this may constrain the Australian-led Regional Assistance Mission to Solomon Islands (RAMSI) operation in the country.

Economic growth of about 5 percent in both 2005 and 2006 has been aided by increased production of palm oil, higher (but unsustainable) rates of logging as well as expansion in the services sector, especially construction. The presence of RAMSI has also boosted demand for goods and services. Inflation of about 8 percent in 2006 reflected robust growth in private credit and strong demand from the expatriate community.

A current account deficit of 16 percent of GDP in 2006 resulted from high oil prices and an increase in non-oil imports used in investment projects. Foreign reserves stood at US\$98 million at end-2006, equivalent to just over 5 months of import cover. While the current account deficit is expected to remain high in 2007, gross reserves are not expected to be adversely impacted, given increased FDI linked to the palm oil and gold mine projects, as well as continued strong official development assistance.

A 25 percent increase in government revenue, aided by improved tax compliance and a growing economy, resulted in a budget surplus of 0.6 percent of GDP in 2006. However, further efforts will likely be needed to maintain fiscal discipline in the medium term. Fiscal risks include the impact of recent large public service wage increases, declining logging tax receipts, lower import duties and aid flows, recurrent expenditure needs, the fragile financial situation of state-owned enterprises and provincial governments and the potential impact of future fiscal decentralization.

Total public debt fell from 80 percent of GDP in 2005 to 70 percent in 2006, while external debt declined from 54 to 50 percent of GDP in the same period. Factors contributing to the reduction in debt include some debt relief received through the Honiara Club negotiations, and the agreement with the Central Bank of Solomon Islands to settle interest arrears and outstanding advances. Debt levels are still high, however, as is the risk of debt distress.