



<i>Population</i>	506,967
<i>Population growth</i>	2.3 percent
<i>Surface area</i>	28,900 sq. km.
<i>Capital</i>	Honiara

Source: World Development Indicators.

Real GDP growth recovered in 2010 from the previous year's external and domestic shocks. The economy is estimated to have expanded by more than 5 percent in 2010 after contracting about 2.3 percent in 2009. The overall production index returned to its mid-2008 levels in the third quarter of 2010. Improved external conditions aided the recovery, although the unsustainable logging sector and aid inflows remain the economy's main drivers. Logging production has been more resilient than expected and reached record levels in late 2010, with 16 percent more logs, worth 46 percent more, exported in the third quarter of 2010 compared with a year earlier. Even with this recovery, however, incomes barely kept pace with the pace of population growth which amounts to about 2.3 percent a year according to the recently-released 2009 census.

By the third quarter of 2010 exports exceeded their pre-crisis peaks. The resurgence in logging explains the increase, although volumes for other exports improved with greater demand. Various sectoral factors contributed as well—agricultural production recovered after the 2009's floods, better boats and the reopening of a tuna cannery supported fishing activity, and improved inter-island shipping services helped cocoa farmers more efficiently transport crops to processors and exporters. International prices for

Solomon Islands' cash crops were buoyant (with the exception of cocoa). These factors and improved government finances all supported domestic demand. Improved external financing conditions and the ongoing benefits of sectoral liberalization attracted investment in telecommunications and mining, with ongoing boosts to these sectors' output.

Consumer prices in Honiara were flat or falling through mid-2010, and higher global food prices are yet to have an impact. Overall consumer prices grew only 0.5 percent from a year earlier in October 2010, and local prices were particularly weak. In October, imported food prices were 6 percent lower than a year before, although a little higher than mid-year, and local food prices have followed a similar pattern. Movements in global food prices affect retail prices in the Pacific nations with a 3-6 month lag, the time it takes for the goods to pass through wholesale and shipping chains. And many of the global food prices that rose in mid-2010 are not relevant for most households in the Solomons, particularly outside the capital Honiara. Rice is the key imported food item in the diets of urban households who still rely on traditional carbohydrates, particularly in rural areas—one third of poorer rural households' total spending is on tubers. Far more important are movements in fuel prices. The dispersed and remote distribution of the population and very limited local production means increases in fuel prices affect all goods. Again there are several months' lag between an increase in global benchmark oil prices and higher fuel costs for local shipping and motorists. By January 2011, the late 2010 increase in global oil prices was beginning to appear in Honiara prices, prompting, for example, a 30 percent increase in taxi fares.

Government finances ended 2010 with a surplus of 4.2 percent of GDP (SBD 193 million) compared with an earlier expected deficit of 5.3 percent. The differences are due to both stronger revenues (7 percent more than projected, in part due to higher logging-related receipts) and spending 16 percent below budget, with the development budget particularly under-spent. The government reports having settled all valid accounts and arrears in 2010, an improvement on previous years. The

government has recently started to post spending and revenue outturns, and other information on the Ministry of Finance's website, a welcome development

Solomon Islands now has a much stronger cash reserves position. The 2010 surplus and the disbursement of SBD 157 million of EU budget support reinforced cash reserves and represents a significant improvement from just two years ago, when cash balances had fallen to dangerously low levels. The 18-month IMF standby agreed in May 2010 has provided a framework to address these issues. The first assessment found the program successfully progress against its targets, and the second tranche of financing was released in November, taking total disbursements to \$9.66 million. Government debt continued to decline, taking the country to 'yellow light' status under the Honiara debt rescheduling agreements. Government debt fell to SBD 1,347 million (29.3 percent of GDP) in November 2010. At these levels the government is now able to access concessional financing.

Monetary conditions eased, with continuing excess liquidity in the banking system, while foreign exchange reserves rose further. The average interest rate on commercial loans declined from over 15 percent in June to 13.6 percent by December 2010 and net interest margins fell as time deposit rates recorded a small increase over this period. Yet private credit growth remained very weak—the stock of commercial loans has declined since mid-2009. Total liquidity in the banking system rose by 7.6 percent to SBD 839 million in November, driven by a continuous rise in largely unsterilized inflows (largely from foreign direct investment and donor support). The SBD remained near 8.1 per U.S. dollar, implying some modest appreciations against major trading partner currencies. Foreign exchange reserves rose to \$257 million or 9.5 months of imports, a significant strengthening from the less-than 3 months' cover in early 2009. To remove some of the liquidity, the central bank resumed auctioning short-term paper (the 28 day 'Bokolo Bill', named after a type of traditional shell currency) with a SBD 20 million auction at the start of February. The Central Bank of Solomon Islands (CBSI) hopes that

these will help to lay the path for establishing a policy interest rate, and to compliment the 56 day and longer Treasury bills which the government largely uses for cash management purposes.

The economic outlook is for growth to strengthen to as much as 7 percent in 2011. Key to this will be the first production and exports from the Goldridge mine, which are expected by March 2011. Logging activity has been surprisingly strong, raising questions about both the sustainability and quality of growth. Given its highly unsustainable pace, the consensus expectation remains for a sharp decline in logging by mid-decade. Private sector investment and activity may be further boosted by the planned release of a third mobile phone operators' license in the second quarter of 2011. The license would include an option to install 3G technology, which allows the use of smart phones and mobile internet.

Important reforms in public financial management, state owned enterprises and utilities, and telecommunications are supporting improvements in service delivery, growth, and public administration. However the full benefits of policy reform have yet to be realized, in good measure due to the challenges to administrative and policy continuity created by political uncertainty. The 2011 budget has been delayed by several months, with government relying on special provisions to extend funding through the first third of 2011. The August 2010 elections produced a coalition with a shifting parliamentary majority. The effect of chronic political uncertainty in Solomon Islands on policy continuity and government effectiveness has given rise to increased demand for political reform among the public and a newly energized media.

## Solomon Islands Key Economic Indicators

	2007	2008	2009	2010e	2011f	2012f
	Year	Year	Year	Year	Year	Year
<b>Output, Employment and Prices</b>						
GDP (% change y-y)	10.7	7.3	-2.2	5.4	5.5	5.0
Tourist arrivals	15,169	18,321	18,050	..	..	..
(% change y-y)	63.6	20.8	-1.5	..	..	..
Consumer price index (% change y-y)	10.9	18.1	1.8	1.0	5.0	4.0
<b>Public Sector</b>						
Government revenues (% GDP)	42.1	45.2	45.3	52.1	52.0	50.0
Government expenditures (% GDP)	40.8	45.5	43.1	47.1	49.7	48.5
Government balance (% GDP)	1.3	-0.3	2.2	5.0	2.3	1.5
Domestic public sector debt (% GDP)	10.1	9.1	8.0	6.4	5.2	4.0
<b>Foreign Trade, BOP and External Debt</b>						
Trade balance (millions US\$)	-75	-69	-62	-128	-90	-81
Exports of goods (millions US\$)	160	193	157	209	274	301
(% change y-y)	41.6	21.1	-18.8	33.0	31.0	10.0
Key export (% change y-y) 1/	27.0	10.1	-20.0	25.0	5.0	-10.0
Imports of goods (millions US\$)	235	262	219	337	364	382
(% change y-y)	33.7	11.7	-16.5	54.0	8.0	5.0
Current account balance millions US\$)	-48	-106	-139	-180	-150	-130
(% GDP)	-8.2	-16.4	-21.1	-24.0	-19.0	-15.0
Foreign direct investment, net (millions US\$)	11	13	10	16	18	15
Total external debt (millions US\$)	173	164	146	..	..	..
(% GDP)	32.1	25.4	22.2	19.4	18.0	17.0
Debt service ratio (% exports of g&s)	5.8	9.7	8.9	9.1	9.1	8.0
Foreign exchange reserves, gross (millions US\$) 2/	121	90	146	266	305	320
(months of imports g&s)	3.9	3.5	4.2	5.6	6.4	6.9
<b>Financial Markets</b>						
Domestic credit (% change y-y) 3/	53.3	26.5	-4.2	1.0	5.0	5.0
Exchange rate (SBD\$/US\$, eop)	7.7	8.0	8.1	8.1	8.1	8.1
Real effective exchange rate (2005=100)	106.5	114.2	119.9	..	..	..
(% change y-y)	-0.9	7.2	5.0	..	..	..
Memo: Nominal GDP (millions US\$)	586	646	657	765	827	900

Source: National data sources and IMF.

e = estimate

f = forecast

n.i. = no issues

1/ Logs

2/ Includes foreign assets of non-bank financial institutions

3/ Domestic credit to the private sector