

## 1998 Speech

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### GOVERNOR'S STATEMENT AT THE LAUNCHING OF THE CENTRAL BANK OF SOLOMON ISLANDS 1998 ANNUAL REPORT

#### WELCOME AND ACKNOWLEDGEMENTS

[Speaker of Parliament, Minister of Finance, Ministers, Members of Parliament, Honourable Chief Justice, Attorney General, representatives of the diplomatic corps, Secretaries to Ministries and other government officials, heads of statutory authorities, bank managers, directors of the Central Bank, managers and representatives of private sector companies, officials of non-government organisations, representatives of the media, ladies and gentlemen]

It is my pleasure to welcome you all this morning to the launching of the Central Bank Annual Report for 1998. This launching provides me the opportunity to fulfill an important responsibility of the Central Bank in presenting an assessment of economic conditions and prospects for Solomon Islands, and to account for the Bank's actions in 1998.

At the outset, I would like to thank all the government departments, statutory organisations, the banks, private sector companies and various individuals who have provided data and information used to complete this Report. Without your support and cooperation, it would have been difficult to complete it. Thanks also to CBSI Directors and other individuals who have provided useful comments on earlier drafts. The assessments and interpretations contained in the Report are of course ours.

#### INTRODUCTION

At this gathering last year, I highlighted five areas that underpin our economic circumstances up till now. These are, weak policies and institutions; a weak public administration and regulatory framework; lack of coordination between all policy arms of government; the absence of a conducive environment for private sector growth; and an apprehension to reforms. The continued negligence of these fundamentals by successive governments has had a detrimental impact on the economy.

It is heartening to note that in the context of its Policy and Structural Reform Program, the present government is addressing, and has made considerable progress on all these areas in the last twelve months.

#### INTERNATIONAL ECONOMY

In the international scene, world output and trade declined significantly in 1998. Reflecting weak global demand conditions, commodity prices and inflation both declined sharply. In addition, the volatility in capital flows and financial turbulence in the merging markets of Asia, Latin America and Russia have severely damaged economies of many countries. In our region for example, the economic down-turn in East Asia has resulted in growth declining from 6.6% in 1997 to 3.7% in 1998 in most of the Asia Pacific region. The economies of Japan and Korea, two very important markets for Solomon Islands exports, experienced sharp downturn in production with the Japanese economy contracting by 2.8% and Korea by 5.5%.

## **DOMESTIC ECONOMY**

Given this international economic environment, 1998 was an extremely difficult year for the Solomon Islands in terms of exports and economic growth. It is estimated that GDP declined by around 7%, mainly on account of the impact of the Asian financial crisis on the logging industry which has traditionally accounted for over 50% of Solomon Island export receipts and about 25% of Government revenues. It is however, gratifying to realize that the Government's policy response to these negative developments have been adequate, timely and decisive thereby, further damage to the domestic economy was mitigated. These policy actions include the tightening of fiscal and monetary policies, the devaluation of the SI Dollar, and the containment of wage awards at a modest level. These actions have also helped Government mobilise significant amounts of financial and technical assistance from multilateral and bilateral sources to avert a balance of payments crisis.

## **REFORMS**

In addition, it was fortunate that our development partners provided strong support to the Government in its efforts to deal with the financial crisis. Of particular importance was the USD\$25 million assistance [of which USD\$15 million was disbursed in 1998] from the ADB, the cash inflows from PNG and the Republic of China and the significant technical assistance through AusAid in support of the structural reforms undertaken by the Government. Undoubtedly the assistance has accelerated the progress of the government's reform programs. Indeed it is worth noting that in terms of its debt and arrears situation, and on macro economic stability, the government has made considerable progress in the last 15 months. The most notable achievements during this period were: -

- Government has paid most of its arrears to external and domestic creditors: hence, it is now current on its interest obligations. The Government is further committed to remain current with its new debt service obligations in 1999 and onwards.
- Interest arrears on government securities up to the end of 1997 are being re- paid in accordance with the installment repayment agreement with the domestic creditors early last year. These payments should be completed by the end of this year.

- Overdue obligations to the National Provident Fund of \$38 million were securitised into long term bonds.
- Public Service restructuring program is on track.
- A large portion of the Treasury Bills stock valued at more than \$200 million was restructured into long-term bonds. This was made possible through the close collaboration and cooperation between the Government, the Commercial Banks, the National Provident Fund and Central Bank.

These actions have been quite effective to the extent that further financial and technical assistance is expected from development partners for the reform programs and rehabilitation process.

## **MONETARY POLICY**

In 1998, the conduct of monetary policy was guided by the need to achieve price and balance of payments stability, while avoiding a severe recession in an economic environment influenced by the collapse of the country's main export markets. Monetary policy therefore has had to be managed in a manner which required a fine balancing act in containing inflation and being mindful of balance of payments difficulties, while avoiding excessive compression in domestic demand. This was further constrained by the inoperative government securities market. The Central Bank therefore, had to rely on its own paper, the Bokolo Bills, to conduct monetary policy.

During 1998, monetary policy was tight. Interest rates on short term Bokolo Bills were doubled and 12 month Bokolo Bills were introduced at the competitive rate of 8.5%. The market was opened up to the general public in order to induce competition with commercial bank deposits. These measures have influenced commercial banks' term deposit rates which rose significantly.

In keeping with this policy stance, and ensuring that public finances are back on track, it is important that the government debt situation is normalised as quickly as possible. Accordingly, the Government successfully negotiated an agreement with major domestic creditors whereby more than 80% of its Treasury Bills stock has been restructured into long term bonds. Furthermore, the Central Bank advances to Government will be securitised as Treasury Bills and sold to the public using an auction process for purposes of conducting monetary policy and to establish a market-determined interest rate. This exercise will also include the phasing out of Bokolo Bills.

As part of the debt restructuring plan, the Central Bank's Liquid Assets Ratio [LAR] was redefined to exclude Treasury Bills; the Ratio now comprises only cash items. At the same time, the ratio was lowered from 40% to 7½%.

## **INFLATION**

Domestic inflation remains a major area of concern. During 1998, and into the early part of 1999 it remained in double digits, inspite of tight monetary and fiscal policies and a relatively stable exchange rate. The annual inflation rate at 12% reflected mainly the effects of the 20% devaluation of the Solomon Islands

dollar in December 1997. The inflationary impact of the devaluation was somewhat mitigated by a weakness in other regional currencies, particularly the Australian dollar and New Zealand dollar, which are the main sources of imported consumer goods for Solomon Islands.

However, the causes of, and factors which influence domestic price movements have yet to be ascertained. In that connection, the Central Bank will research into the structural causes of inflation such as the pricing behaviour of major importers and state enterprises; the impact of supply constraints such as the scarce availability of land for housing and their impact on rental costs; the state of infrastructure such as roads; and the price regulatory regime by the Price Control Unit. We hope to make the findings of the study available to the Government so that appropriate action could be taken to curb inflation.

## **THE BALANCE OF PAYMENTS**

The balance of payments outcome for 1998 was favorable with the foreign reserves position improving from \$151 million in 1997 to \$234 million in 1998. The improvement was mainly the result of the generous support from development partners, particularly the Asian Development Bank which disbursed around \$76 million, and substantial inflows from the governments of PNG and ROC last year. However, the underlying balance of payments position remains weak with heavy reliance on imports and dependence on a relatively narrow export base. In that connection, the opening of the Gold Ridge gold mine last year is a welcomed development in establishing a more diversified export base.

The external reserves were maintained at levels much higher than ever before. However, the Central Bank's objective is to build this further to around 5 to 6 months of import cover. This is important not only for balance of payments purposes, but also for creating confidence in the Solomon Islands dollar and the economy.

## **OUTLOOK**

The outlook for 1999 is good. The economy should be able to achieve a growth rate of 2-3%, reduce the inflation rate down to pre-devaluation levels, and achieve a reasonable balance of payments outcome. Total production should rise as export prices improve. This is achievable provided, sound macro-economic policies are vigorously pursued.

The main risk to the economy in 1998 was the political instability, which delayed implementation of necessary reforms. In 1999 the main risk comes from the law and order problems, especially those emanating from the current social unrest. Besides that, the rising abuse of drugs and youth related problems may severely damage the social

fabric. These problems will put pressure on government finances and have the potential of reversing the momentum gained in the last few months. Furthermore, the continuing weaknesses in the economies of our main export markets are cause for concern in terms of our trade with the rest of the world. These risks aside, the prospects for 1999 are good.

## **CBSI OPERATIONS**

Now I would like to say just a few words on the Bank's operations in 1998. The total balance sheet of the Bank grew by 33% last year compared to an increase of 18% in the previous year. However, net profits last year were \$2.55 million compared with \$3.3 million in 1997. This decline attributed mainly to lower external interest earnings, higher domestic interest costs associated with the conduct of monetary policy through the issue of Bokolo Bills, and higher staff costs due to staff and organisational restructuring. The restructuring process, which is continuing this year, will also include the conversion of the Bank's senior management positions to fixed term contracts, and to control costs, the Bank is also out-sourcing more of its services. When the financial sector reforms are implemented, the Bank's role and activities will be expanded, particularly in terms of its supervisory functions. In 1999, we hope to take up necessary amendments to the Financial Institutions Act, which will include provisions to prohibit pyramid selling schemes and other get-rich-quick money schemes.

During the year, the Bank's working relationship with the government has been and continues to be very cordial. The Bank has been actively involved in the formulation of, and is active in the implementation of the Policy and Structural Reform Program, as well as in other areas of policy dialogue.

## **CONCLUSION**

Ladies and gentlemen, the 1998 Annual Report would not be possible to complete without the support and cooperation of many of you, for which we are very grateful. In particular, I would like to acknowledge the contributions and services of the members of the CBSI Board, including three former Directors who served till late last year. I want to thank Mr John Adifaka, Rev. Ellison Pogo and Mr Laurie Chan, for their guidance and advice. Thanks also to our External Auditors – Price Waterhouse & Coopers - and the Auditor General, for the timely completion of the Bank's Annual Accounts. Also our printers for getting the Report in time for this morning's launching. I should also like to say thanks to the SIBC for the use of these facilities, and to Ms Maeke for providing the catering services. Lastly, I would like to thank my own staff of the Economics and Corporate Services Departments whose efforts are fulfilled by the publication of this Report.

In conclusion, I would like to make reference to a point I made in my talk during this occasion last year: that is, we have resolved to and embarked on a long and difficult journey of reforms. It is important that we carry on the task with persistence and determination otherwise we may lose the gains we have already made. The international

community has demonstrated its confidence in the government's reform programs. Likewise, our own private sector has shown

confidence and its readiness to play its part. I encourage the government to take advantage of these positive changes. That will need strong political will, the cooperation and partnership of everybody in the community. Lest we become complacent, we must be reminded that we have not come out of the woods yet. As I alluded to earlier, the ingredients for a turn-around in the economy are present. Let us therefore get on with the task at hand to make a better Solomon Islands for us all and our future generations.

Ladies and gentlemen, may I now commend the Central Bank's 1998 Annual Report for your reading and I thank you for listening.