

# **Statement by Governor Denton Rarawa on the Occasion of the Launching of the 2008 Annual Report of the Central Bank of Solomon Islands, Mendana Hotel, May 13 2009**

## **Salutations**

Acting Prime Minister, Hon Fred Fono, Minister of Finance Hon Snyder Rini, Members of Parliament, Representatives of the Diplomatic Corps, Senior Government officials, Central Bank Directors, Heads of Statutory Authorities, Commercial Bank Managers, Representatives of Non-Government Organizations, Representatives of the private sector, Representatives of the media, Ladies and Gentlemen,

Good morning. First of all, let me warmly welcome you all to the official launching of the Central Bank's 2008 Annual Report, my first after being appointed as the Governor of the Central Bank in August last year. This is an important occasion in the Bank's calendar of events because it provides an opportunity for me to comment on the performance of the economy in 2008 and the prospects for 2009. I will also take the time to account for the Bank's operations in 2008.

## **Introduction**

Ladies and gentlemen, my presentation this morning, understandably, will be dominated by the current global economic crisis and its impact on our country. The theme of my presentation is: *"Riding out the Storm" how do we ensure that we survive and come out of the global crisis.*

Some commentators have used the analogy of a small boat caught up in the middle of a wild storm on the high seas to describe our current situation. We don't know how strong the storm will be or how long it will last. But one thing we know: we must try our utmost best to protect our boat and ensure it doesn't sink in the storm; and maybe hope and pray that the storm quickly passes. A lot of us here this morning are deck hands on that boat. We play different roles in our country. How do we ensure that *MV Solomon Islands* survives the storm?

I believe the global economic crisis has given us an important opportunity to reshape our future. This is the critical challenge currently facing our country. I will come back to this later towards the end of my presentation.

## **International and Domestic Developments**

But first, let me briefly survey the global landscape and how recent developments have affected economic performance in Solomon Islands.

The last four years saw rapid and sustained global growth combined with low and stable inflation. This all changed in the fourth quarter of 2008. What started out in the US as a problem in the subprime mortgage market erupted in September, and turned into a contagious global financial crisis that soon mutated into the most challenging global economic crisis since the Great Depression. The crisis exposed massive regulatory weaknesses and market failures in the global financial architecture. This resulted in governments in advanced countries intervening with stimulus packages to restore confidence and avert the collapse of their economies.

The Asian region which has been growing rapidly over the years declined. China, the powerhouse of growth in the region saw exports dropping to a record low in ten years. Resilient domestic demand and high level of foreign reserves have partially cushioned most Asian economies from deteriorating further.

Closer to home, the Australian economy did not fare as badly as other industrialized nations, but still contracted by 0.5% in the final quarter of 2008, following eight years of economic expansion. Overall, the International Monetary Fund (IMF) has estimated the global economy has contracted by 6.25% in the final quarter of 2008, reversing the 4% growth witnessed a year earlier.

What has this to do with Solomon Islands, one may ask? We are so far away from the epicenter of global financial and economic activity. But we are part of the world community and the global developments have a lot of bearing on our economy. Given our small and open economy, our vulnerability to external shocks is inevitable.

### **Impact on the Solomon Islands Economy**

Ladies and gentlemen, let me now turn to the impact of the current global financial and economic crisis on the Solomon Islands economy.

2008 will go down in history as the most turbulent year the global economy has ever witnessed since the end of World War II. As I mentioned earlier, the crisis has exposed severe systemic failures in the markets and regulations around the world. The impact of the crisis is been felt across the globe.

Solomon Islands is not immune to the adverse effects of the global economic crisis. The crisis would result in the following. First, our export receipts will fall because international demand for our export commodities has shrunk and export prices have declined. This means loss in foreign exchange for the country; the implication of this is dwindling foreign reserves. The fall in exports also means a drop in Government revenues. At the micro level, the fall means loss of income to firms and individuals. This leads to lower or loss in profits of businesses that could translate into loss of jobs for employees. When this happen on a wider scale, this leads to rising unemployment and other undesirable social consequences.

The fall in income means a reduction in the standard of living of the population and an increase in poverty. This in turn puts further pressure on the country's resources. It is this chain of

transmission that we want to minimize because once it flows in, it will be very costly for the economy. Since there is lag in the transmission of these effects, the full extent of the impact of the crisis may be yet to come and would be felt this year and onwards.

So far preliminary indicators for the first quarter of 2009 show mixed outcomes. For example, in terms of production, except for palm oil, all the major commodities recorded declines. Provisional data on Government revenues indicate a 20% drop from the previous quarter. Although our foreign reserves have been stable since the beginning of the year they are projected to be lower this year than last year.

Economic policy should be geared towards protecting the existing environment from further deterioration until such time we know that we have weathered the storm. In terms of fiscal policy, this means expending of public funds must be economically justified. Proper appraising, monitoring, evaluation mechanisms must be in place to avoid unnecessary spending.

In this context, the Government's announced strategies to mitigate the effects of the global economic crisis are welcome, especially plans to prioritize spending, continue with necessary reforms, introduce revenue enhancement measures and closely monitor the balance of payments situation. If government follows through with rigorous implementation of these intentions, they will go a long way in addressing the challenges facing the country.

The current global economic crisis has slowed down many government programs and therefore it is crucial the Government reprioritize its programs and reallocate resources (including the RCDF) to essential areas such as infrastructure and productive sector development. Budgetary support from the donor community has assisted but that cannot be taken for granted as the global economic crisis affects everyone including the donor home countries.

Ladies and gentlemen, while other advanced governments injected massive stimulus packages into their economies, Solomon Islands does not have the resources to do so. The best we can do is to re-allocate our meager resources to gain the maximum benefit.

In terms of monetary policy, tackling the high inflation in the country and preserving the foreign reserves had been the priority focus. The Central Bank is aware of the ramifications this has on the private sector, but the current liquidity level is deemed sufficient.

The Central Bank will maintain monetary tightening in the short to medium term until inflation subsides to 10% or less and the level of foreign reserves is at least at 3 months import cover. The Bank will monitor and act accordingly to accommodate economic growth.

Ladies and gentlemen, let me quickly look at some of the main indicators of economic performance in 2008.

The Solomon Islands economy is estimated to have **grown** by 6.7% in 2008, down from 10.7% in 2007. The main drivers of this are fisheries, government services, agriculture, transport and communication, and manufacturing sectors.

Annual **production** rose by 10% in 2008 owing mainly to strong output in the first three quarters of the year due to favourable prices of our major export commodities.

**Log production** rose by 4% to a record level of 1.5 million cubic metres. **Fish catch** increased by 20% to 25,000 tons in 2008 due to favourable fishing conditions and high prices during the year. **Copra production** recorded yet another year of strong growth, rising by 40% to 39,000 tons in 2008, while **cocoa production** rose negligibly by 0.2% to 4,300 tons in the same period.

**Palm oil production** remained buoyant in 2008 with crude palm oil recording nearly 22,000 tons and **palm kernel** rose to 6,100 tons.

## **Inflation**

The average annual inflation rate as measured by the three months moving average rose to 19.4% in 2008 compared to 10% in 2007. This reflected high food and fuel prices in the first half of the year. As we all know, high inflation is bad for the economy because it erodes people's incomes and profits of businesses. So it is critical that fighting inflation is a priority policy objective for the country and the Central Bank took monetary policy action towards the end of last year to bring down inflation.

## **Balance of Payments (BOP)**

The overall balance of payments registered a deficit of \$120 million in 2008. This outcome stemmed mainly from mismatches in the trade balance, income account, and the services account. As a result of the outcome in the balance of payments, the level of foreign reserves dropped by 22% to \$716 million at the end of 2008. This level of reserves is equivalent to 2.6 months of import cover, compared to 3.9 months in 2007.

## **Government Finance**

The total stock of government debt at the end of 2008 fell by 6% to \$1.5 billion, of which \$1.1 billion were external and \$385 million were domestic debts. It is heartening to note that Government has consistently reduced its external arrears to \$25 million at the end of 2008 from \$79 million in 2007.

## **Monetary Developments**

Monetary developments in 2008 were characterized by increase in money supply, reflected by a 39% growth in domestic credit to \$1.3 billion. Net foreign assets (NFA), on the other hand, fell 13% to \$716 million reflecting the deterioration in the balance of payments.

Credit to the private sector rose by 27% to \$129 million in 2008. Net credit to Government increased from minus \$54 million to positive \$38 million. In past years the buildup in Government deposits has been an automatic stabilizer in aiding efforts to contain inflationary pressures. In this regard, increase in net credit to government reflects government's drawdown of its deposits with the Central Bank.

In the last few years, the Solomon Islands financial system had been very liquid. As the excess liquidity in the system were converted into loans, the pressure on our foreign reserves and inflation began to mount, the situation exacerbated by rising food and fuel prices. Faced with this situation, the Central Bank acted to mop up the excess liquidity. This was done by redefining the Liquid Asset Ratio (LAR) to include only call deposits of the commercial banks with the Central Bank and introducing Bokolo bills and deposits.

Ladies and gentlemen, the conduct of monetary policy in 2008 was primarily aimed at curbing inflationary pressures and maintaining adequate foreign reserves. Inaction would have placed the country in a far worse situation.

### **Outlook for 2009**

Let me now turn to the outlook for 2009 for the domestic economy.

Ladies and gentlemen, this year's outlook is not as good as 2008. It is estimated that the economy will grow by around 1% in 2009. This growth is expected to be driven mainly by the transport and communication, construction, fishing, and manufacturing sectors.

Production of logs and copra is projected to decline in 2009. Fish, cocoa and palm oil, on the other hand, are projected to increase. Exports of our commodities will depend very much on our exports markets – mainly the Asian region. Many of these countries have been severely affected, and the IMF has projected growth in Asia to contract to 1.3% in 2009.

The balance of payments is projected to remain in deficit as exports continue to be depressed. As a result, our foreign reserves are projected to remain under pressure. This is an area that our development partners can help in and arrest further deterioration in the balance of payments. The idea of bringing forward donor funds for committed projects has merits and need to be considered seriously. I am fully aware that our donor's home countries are also affected by the global crisis, but if there is a time when we really needed help, this would be it.

On the monetary sector, the money supply is expected to rise, triggered mainly by expected continued rise in credit. CBSI, however, will continue to monitor this and should the need be, will intervene to avoid excessive monetary growth in the system.

In other words, ladies and gentlemen, 2009 is expected to be a very difficult and challenging year for our country. The global economic crisis has made an already difficult situation even more difficult.

## **Challenges and Opportunities**

Ladies and gentlemen, let me say a few words about potential challenges and opportunities that may arise from the global economic crisis.

### **The Crisis can be a source of Opportunity**

There is a saying that says “there is always sunshine after the rain”. The global economic crisis although will adversely affect us, let us view it as an opportunity for us to reshape the future of our country. The crisis presents opportunities to take stock, to reform, to make hard decisions and to act decisively. It is an opportunity to re-look at how we do things. It is a chance to eliminate wastage, a chance to be creative and innovative. The crisis has given us the opportunity to examine ourselves and may be the need to change our attitude, towards life and work. Gone are the days of easy money; one must sweat before an outcome is realized - there is no such thing as free lunch.

I am confident Solomon Islanders can rise to the challenge because they are resilient people. But we have to grasp those opportunities to create new relationships with all stakeholders in the country and with our development partners to find new common grounds we can mutually flourish our relationship, as well as our development aspirations.

### **Cooperation required from all stakeholders**

During these difficult and trying times, it is critical that we all work together to come up with possible measures to cushion against these adverse effects. There is urgent need than ever for greater cooperation and stronger partnership among stakeholders in the country. The Government, Private sector, NGO's, the public and our development partners must work together to deal with the challenges head-on. Because we are all in the same boat: if we don't work together we will sink and all perish.

### **Invest to remain afloat**

Despite the challenges we face, we must continue to invest in our future. Infrastructure and productive sector development must be at the forefront of our efforts. Our development partners can play a critical role in this regard. I fully concur with the call for donor funded projects to be fast-tracked and where possible, greater procurement of local materials or employment of labor intensive programs to engage more people in the development efforts of our country.

Let us also invest in our rural economy, the farmers, the fishermen and the sector of our society that supports the livelihood of 85% of our population. In these difficult times this sector can become the safety net for many people. This was proved in the past and will be the case in the future.

## **Operations of the Central Bank in 2008**

Let me now turn to the operations of the Central Bank in 2008.

The highlights of the Bank's activities are described in Chapter 8 of the Annual Report. Last year had seen changes in the executive management of the Bank. Mr. Rick Hou ended his term as Governor in August, and I replaced Rick. My post as Deputy Governor was taken up by Mr. Gane Simbe, who was then one of the senior Managers of the Bank.

Two new Directors, Sir Thomas Chan and Mr. Leslie Teama, were appointed in 2008 for a period of three years. Another two Board positions are still vacant.

The Bank consulted the credit unions on the amendments to the Credit Union Act. And the review of the Insurance Act that commenced in 2007 slowed down due to difficulties in securing the services of a technical expert and a legal draftsman for the task. The Central Bank Act was reviewed in 2008 but more work still needs to be done before it is ready for parliamentary approval.

The accounts of the Central Bank continued to be prepared in conformity with the International Financial Reporting Standards (IFRS). At the same time, the Central Bank continued to produce its annual financial statements in compliance with the CBSI Act. Until the CBSI Act is amended, the Central bank will produce its annual financial statements with two net operating profit/(loss) figures.

The impact of the global financial and economic crisis affected the financial operation of the Central Bank. Under the CBSI Act the Bank made a net profit of \$6 million, whilst under the IFRS it was a net loss of \$76 million. The difference is in the treatment of unrealized gains or losses on exchange rate movements as income or expenses. The net profit of \$6 million was appropriated by the Board according to the provisions of the CBSI Act.

## **Conclusion**

Ladies and gentlemen, to conclude, let me return to the analogy of the boat in the middle of the storm I made in my opening remarks.

In the midst of this global economic crisis, what must MV Solomon Islands do to keep afloat? The captain, crew and passengers must do all they can to keep the boat afloat and survive the storm. They must strike the right balance between continuing on the journey through the storm on full speed and/or turning off the engine and rolling with the waves and hope the storm quickly passes. I would suggest the captain and crew members should slow down and keep the boat facing the head wind and slowly chug along using whatever available instruments at their disposal and seamanship skills to keep the boat afloat. Likewise all stakeholders in our country must redirect our energy and resources to ensuring our economy weathers the effects of the global economic crisis.

I am aware this is a big ask, but if all of us can play our part well, we will keep the MV Solomon Islands afloat. This calls for sacrifice, change of attitudes, and skillful re-direction in how we do things. As I said earlier, the global economic crisis presents unique opportunities for us to change direction and reshape our future. If we grasp those opportunities then I believe we will come out of the storm much stronger and well prepared for the next storm.

Finally, ladies and gentlemen, before I end I would like to acknowledge the contribution of various people in the production of the 2008 Annual Report; the Office of the Auditor General and our External Auditors, Deloitte of PNG, for completing the financial accounts on time; our printers EN Digital Printing Technology Ltd, for ensuring the report is ready for this morning. My sincere gratitude goes to the management and staff of Solomon Kitano Mendana Hotel for providing these excellent facilities for our use this morning. I also express my thanks to the financial institutions; government departments, statutory authorities, donors, non-governmental organizations, private sector and others, who have kindly provided both information for this report and time for our consultations with you. The analysis and/or errors of course remain our responsibility. I also acknowledge the invaluable advice and guidance on the final version of the report rendered by the CBSI Board Directors. Finally, a special thank you to my staff, especially the Chief Manager and the Staff of the Economics, Research and Statistics Department, the Chief Manager and staff of Finance and IT Department, and all the other Chief Managers and staff of the Bank who have assisted. These officers have untiringly worked on the various sections of the report over the last several weeks, to ensure this report is completed and ready for this morning.

With these few remarks, ladies and gentlemen, let me commend the 2008 CBSI Annual Report for your reading.

Thank you for listening and **God bless Solomon Islands.**