# CENTRAL BANK OF SOLOMON ISLANDS

## QUARTERLY REVIEW

**September 2012**

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The Quarterly Review is prepared by the Economics Research and Statistics Department of the Central Bank of Solomon Islands and published four times a year. All enquiries pertaining to the Review should be addressed to:

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## GENERAL NOTE

| | |
|---|---|
| p | provisional |
| e | estimate |
| - | nil |
| n.a. | not available |

(i) The sum of the components may differ from the totals in some instances due to rounding.

(ii) Data are subject to periodic revision as more updated information becomes available.

## GLOSSARY

*The following terminologies are defined in the context of Solomon Islands.*

**Balance of Payments (BoP):** records all payments and receipts relating to the movement of funds between a country and foreign countries.

**Bank Liquidity:** Total amount of cash held by banks and not used for investment or other transactions.

**Capital account**: records international transactions relating to the flow of capital between a country and foreign countries, such as investment, loans etc.

**Current account:** records international transactions relating to the flow of goods, services, income and gifts. A surplus indicates higher inflows than outflows and a deficit indicates the opposite.

**Domestic credit:** value of loans and advances obtained from within the country.

**Excess Liquidity:** The liquidity that banks possess that is greater than the minimum prescribed by the Central Bank.

**Exchange rate:** the price of foreign currencies stated in terms of the local currency or the vice versa.

**Exports:** goods that a country sells abroad.

**External reserves:** stock of foreign currency assets of the Central Bank. These assets are earned though exports, foreign aid and loans obtained from institutions abroad.

**Gross Domestic Product (GDP):** Total value of all final goods and services produced in an economy during the course of a year.

**Honiara Retail Price Index (HRPI):** a consumer price index which shows the price level and changes in price level of goods and services in Honiara over time. This information forms the basis for calculating inflation in the economy.

**Imports:** goods that a country buys from abroad.

**Liquidity Asset Requirement:** Usually defined as a percentage of deposit liabilities of a commercial bank that shall be hold as cash or as balance with the Central Bank.

**Money Supply:** the total quantity of money in a country's economy at a particular time.

**Narrow money:** notes and coins in the hands of the public plus money held on demand deposits at the Central Bank.

**Net Credit to Government:** value of borrowings by Government less its deposits at the banks and the Central Bank.

**Private sector credit:** value of borrowings by private companies and individuals within the country.

**Quasi money:** Total of time deposits and savings deposits.

**Trade balance:** the difference between merchandise exports (goods sold overseas) and merchandise imports (goods purchased from overseas).

**Trade surplus/deficit:** a trade surplus is when the value of exports is higher than the value of imports, whilst a trade deficit is when receipts from exports are less than payments for imports.

# 1. OVERVIEW AND ANALYSIS

Global economic conditions deteriorated in the September quarter 2012 amidst deepening economic slowdown in the Euro area and other major emerging economies. The softer growth in the emerging economies reflected the negative repercussions of the reduced external demand arising from trade and financial linkages with Europe. Consequently, this has broader effects on domestic demand as the global economic recovery still remains at risk.

In emerging Asia, China and India, the world's second and third largest economies respectively, continued to experience a slowdown in economic performances, attributed to declines in investments and output due to reduced external and domestic demand. China expanded at its slowest pace since 2009 during the third quarter growing by 7.4% whilst India recorded a 5.5% growth, the weakest growth in three years.

With the slowing global growth and tensions with China, the Japanese economy shrank in the September quarter for the first time since 2011. Despite the favourable performance across the first half of this year on robust private consumption and reconstruction spending following last year's earthquake, Japan registered only 0.1% growth during the quarter.

While the USA economy showed a modest pickup in the third quarter, growing by 2.7%, the Euro zone economies shrank by 0.2% during the quarter, extending the 0.2% contraction in the previous quarter. This outturn reflected developments in the majority of the Euro-zone countries, which continued to be mired in a downturn. In Germany, manufacturing activity remained in a downtrend despite buoyant exports in August.

Latest indicators pointed towards subdued economic activity in New Zealand in the third quarter as reflected by the decline in the manufacturing and services sectors. The decline also contributed to high unemployment rate rising by 7.5% during the quarter. Similarly, apart from increased resource project investments and consumer spending, the Australian economy grew by only 0.5% in the third quarter, slowing from 0.6% in the previous quarter.

On the domestic front, the Solomon Islands economy saw a rebound in production in the third quarter as reflected by the CBSI production index rising by 14% to 123 points. Positive outcomes were noted in log, fish and copra productions counteracting the falls in palm oil, cocoa and mineral.

**Table 1.1 Macroeconomic Indicators**

| | 2011 | | 2012 | | |
|---|---|---|---|---|---|
| | Sep | Dec | Mar | Jun | Sep |
| Money Supply ($ millions) | 2433 | 2610 | 2631 | 2923 | 2978 |
| Net Foreign Assets ($ millions) | 2635 | 2866 | 3089 | 3358 | 3493 |
| Net Domestic Credit ($ millions) | 374 | 324 | 185 | 76 | 117 |
| Interest rate margin (%) | 11.2 | 10.0 | 8.9 | 10.3 | 10.7 |
| Trade in goods balance (f.o.b.) ($ millions) | 17 | 37 | 165 | -60 | 15 |
| Gross foreign reserves ($ millions) | 2702 | 3034 | 3280 | 3507 | 3656 |
| Recurrent revenue ($ millions) | 557 | 680 | 568 | 612 | 581 |
| Recurrent expenditure ($ millions) | 464 | 535 | 462 | 566 | 519 |
| Production index (2008=100) | 132 | 122 | 118 | 107 | 123 |
| Inflation (%) | 8.9 | 10.1 | 7.3 | 7.1 | 4.7 |

**Source**: Central Bank of Solomon Islands

Manufacturing activities improved during the quarter. Labour market conditions were upbeat as reflected by the Solomon Islands National Provident Fund (SINPF) contributors rose to post a quarterly average of 46,567 employees. Electricity production indicates some signs of improvement rising by 5% while electricity consumption declined during the quarter.

Inflation slowed to 4.7% in the September quarter from 7.1% in the June quarter driven by lower domestic and international prices. This downward trend reflected slowdown in general price pressures underpinned by lower commodity prices, fuel and local market prices during the quarter. This indicates that developments on both international and domestic fronts showed no additional upside risks to inflation forecasts in the coming months.

On external conditions, buoyant export performance driven by strong log and fish production resulted in a trade surplus of $16 million in the third quarter from a trade deficit in the previous quarter. Log export receipts rose by 22% due to higher shipment volumes while the increase in fish exports to $170 million was fuelled by favourable international fish prices, output and weather conditions. The services account also indicates significant improvement, with a narrowing in the net deficit to $70 million in the third quarter. In contrast, the primary and secondary income accounts deteriorated with the former increasing to a deficit of $109 million and the latter declining to a surplus of $114 million. The deficit in the primary income account owed to high investment outflows whilst the reduction in the secondary income account surplus was driven by decline in donor inflows. This resulted in a net deficit of $50 million in the current account in the third quarter.

In the banking sector, net domestic credit increased by $40 million to $117 million. This outturn was largely dominated by the recovery in private sector credit rising by 2% during the quarter. Lending by commercial banks also went up by 3% with personnel, communications, agriculture and fisheries sectors as the major drivers during the third quarter.

Reserve money (M0) increased at a slower pace by 2%, arising from a smaller 5% increase in the Central Bank's net foreign assets (NFA) compared to the previous quarter. Subsequently, liquidity in the banking system registered a marginal increase of 3% with free liquidity rising by 3% during the quarter. Mirroring the trend in base money were narrow money (M1) and broad money (M3) rising by just 3% and 2% respectively, during the quarter.

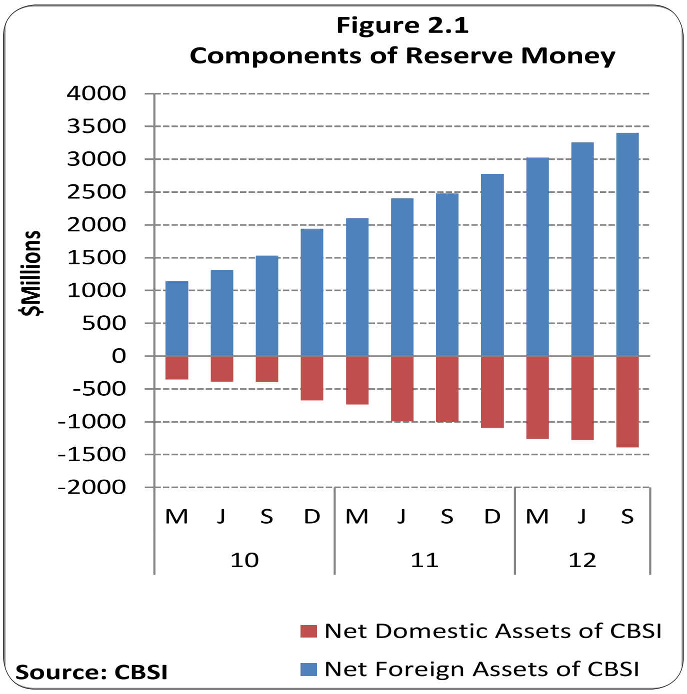
Fiscal performances improved considerably with Government registering a recurrent surplus of $63 million, attributed to lower spending during the quarter. Total public debt stock declined by 4%, mirroring the fall in both the external and domestic debt stocks. This indicates the Government's commitment as reflected in the increased debt servicing during the quarter.

## 2. MONEY AND BANKING

Monetary developments in the third quarter of 2012 saw a continued but slowed growth in all the key monetary aggregates. Movements in base and broader measures of money reflected a slowed increase in net foreign assets (NFA). Liquidity continued to increase largely supported by strong growth in net domestic credit during the quarter. Commercial bank deposit rates continued to decline whilst lending rates remained unchanged resulting in a wider interest rate margin by end of the third quarter.

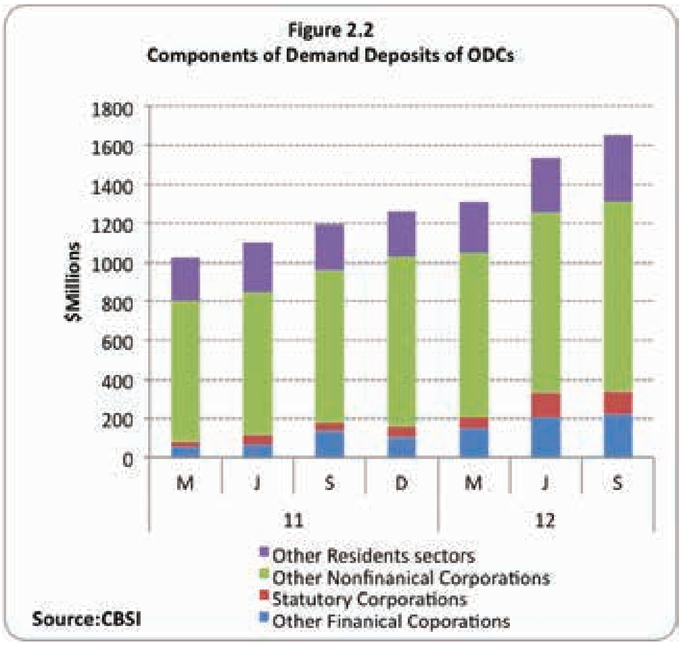
**Reserve Money**

Reserve money (M0) expanded at a slower rate this quarter at 2% to $1,987 million from a 12% increase in the previous quarter. The increase in M0 was largely driven by the 5% rise in Central Bank's NFA to $3,403 million. Net Domestic Assets (NDA) of CBSI also increased by 9% to minus $1,392 million as a result of a buildup in Bokolo bills balance and adjustments made to Capital Accounts (See figure 2.1). Compared to the same period a year ago, reserve money was up by 35%.



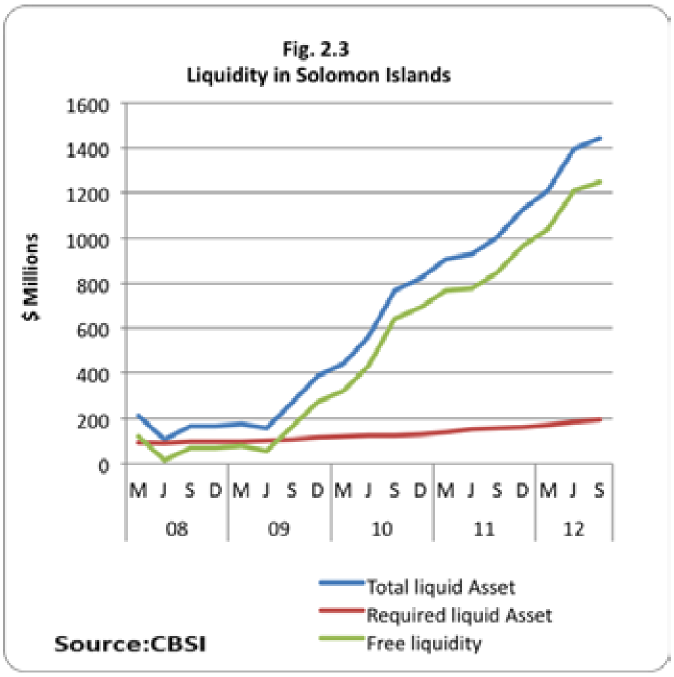

**Liquidity**

Liquidity at the end of September quarter totalled $1,443 million, a marginal increase of 3% following a 15% increase in the previous quarter. The increase was owed to a rise in M0, largely driven by an increase in Central Bank's NFA and NDA. As a result, free liquidity increased by 3% to $1,249 million after accounting for the 7.5% cash reserve requirement. Prevalent high levels of liquidity were mainly attributed to the buildup in gross foreign reserves over the past quarters.



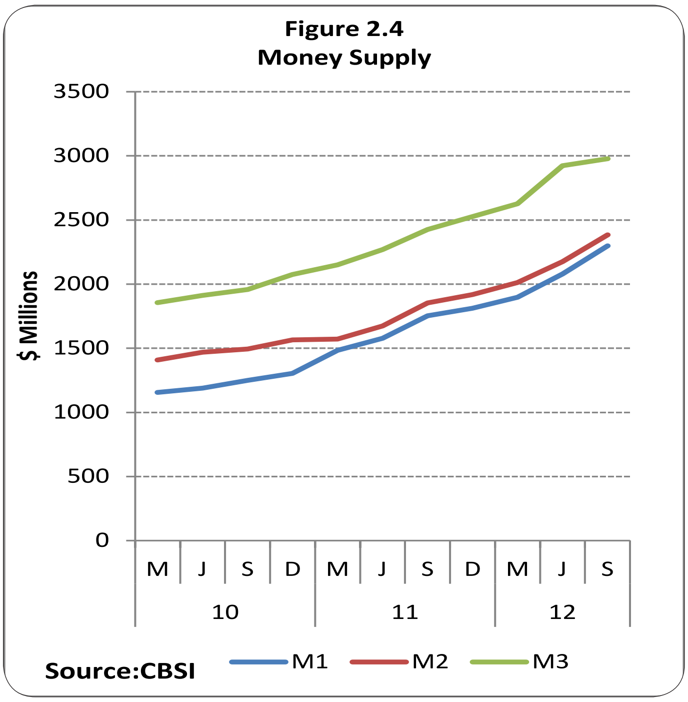

**Narrow Money (M1)**

Narrow money (M1), comprising of currency in circulation outside depository corporations and demand (transferable) deposits held by ODCs continued the upward trend, rising by 3% to $2,300 million this quarter, following the 17% increase in the previous quarter. The increase in M1 came from the 5% increase to $1,811 million in demand deposits counteracting the 3% fall in currency in circulation to $489 million. Underpinning the increase in demand deposits was the 6% increase in ODC's transferable deposits to $1,779 million on the back of increases in other resident sectors, other financial corporations and other non-financial corporation's domestic demand deposits.




## Money Supply (M3)

The overall money supply (M3) grew slowly by 2% to $2,978 million this quarter compared to the 11% growth registered in the previous quarter. Driving the slowdown in M3 was the 3% decline in other deposits (time and savings) that counteracted the 3% rise in M1. Meanwhile, NDA increased to minus $646 million this quarter from minus $427 million, resulting from increases in net domestic credit.




## Domestic Credit

Net domestic credit increased by $41 million to $117 million this quarter, in contrast to a 59% fall in the previous quarter. The increase in NDC was led by private sector credit growth and drawdown of government deposits in the banking system that resulted in a downward movement in net credit to government to minus $1,112 million from minus $1,129 million in the previous quarter.

Credit lending by commercial banks went up by 3% to $1,186 million this quarter driven by growth in loans and lease financing. Loans went up by 5% to $959 million whilst lease financing rose 4% to $74 million. Sectors that contributed to the credit growth were personal loans that went up by $26 million to $358 million, communications was up by $22 million to $112 million, agriculture from $20 million to $23 million, fisheries increased by $2 million to $4 million and statutory corporations increased from $0.4 million to $3 million (See table 2.1).

**Table 2.1**
**Distribution of ODCs Credits by Sector**
**SBD'000**

| Sectors | June 2012 | | September 2012 | |
|---|---|---|---|---|
| | Value | % | Value | % |
| Personal | 332389 | 28.7 | 358022 | 30.2 |
| Distribution | 181116 | 15.7 | 179297 | 15.1 |
| Construction | 173760 | 15.0 | 159322 | 13.4 |
| Communications | 89705 | 7.8 | 111732 | 9.4 |
| Tourism | 72872 | 6.3 | 74087 | 6.2 |
| Pro. & Other Services | 67591 | 5.8 | 69117 | 5.8 |
| Transport | 64219 | 5.6 | 61631 | 5.2 |
| Manufacturing | 58013 | 5.0 | 58707 | 4.9 |
| Forestry | 46981 | 4.1 | 47619 | 4.0 |
| Bills Receiveables | 25037 | 2.2 | 22716 | 1.9 |
| Agriculture | 19884 | 1.7 | 16051 | 1.4 |
| Entert'mnt & Catering | 16561 | 1.4 | 14993 | 1.3 |
| Mining & Qyarrying | 6488 | 0.6 | 5311 | 0.4 |
| Fisheries | 1637 | 0.1 | 4168 | 0.4 |
| Statutory Corporations | 370 | 0.0 | 2926 | 0.2 |
| Private Financial Institutions | 191 | 0.0 | 320 | 0.0 |
| Non-Resident | 152 | 0.0 | 99 | 0.0 |
| Central Government | 0 | 0.0 | 8 | 0.0 |
| Provincial Assemblies & Local | 0 | 0.0 | 0 | 0.0 |
| **Total** | **1156966** | **100** | **1186126** | **100** |

ODCs - Includes the commercial Banks and Credit Corporation of Solomon Islands

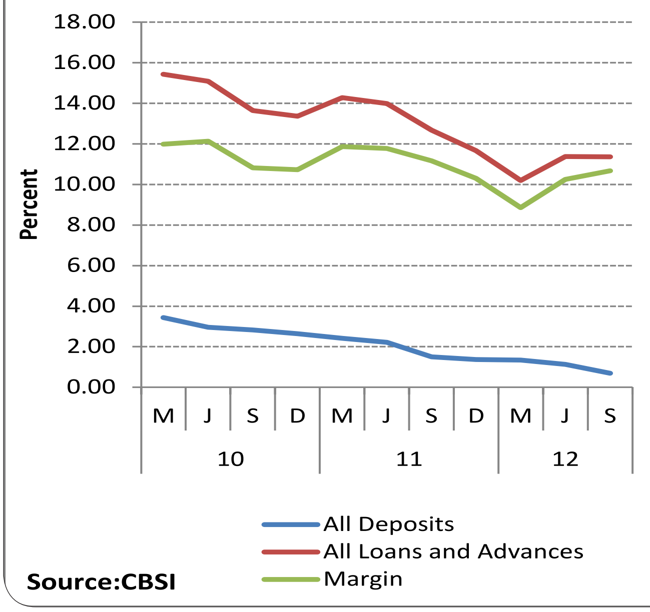
## Domestic Market Operations

A total of $29 million worth of Government treasury bills were floated during the quarter. The amount of bids received totaled $70 million, an 8% drop from the last quarter. The weighted average yield (WAY) for 56-days bill fell from 1.65% to 0.85%, 91-days bill went down from 1.76% to 0.94% and 182 days-bill dropped from 1.75% to 0.66%.

**Interest Rates**

The commercial banks indicative weighted average interest rates on deposits dropped further to 0.69% this quarter from 1.1% in the previous quarter. The fall was a result of decline in interest rates offered on short-term deposits, mainly maturities of 3 to 6 months, 6 months to 1 year and 2 years to 3 years. Meanwhile, the weighted average lending rate remained unchanged at 11.4% this quarter. As a result, the weighted interest rate margin widened slightly from 10.3% in the previous quarter to 10.7% this quarter.

Figure 2.5
ODCs weighted average interest rates




Source:CBSI

## 3. GOVERNMENT FINANCE

Preliminary fiscal outcome in the September quarter showed a recurrent surplus of $63 million, compared to a revised surplus of $45 million in the previous quarter. The consecutive quarterly surpluses reflected the government's ongoing commitment to contain recurrent spending within collected revenue. Total public debt stock fell this quarter by 4% against the second quarter to $1,050 million.

**Revenue**

Total revenue including grants fell 6% against the second quarter to $591 million, of which domestic revenue represented $581 million and grants $10 million. The quarter on quarter decline was influenced mainly by lower collections from Inland Revenue Division (IRD) that outweighed slight increases in revenue from other ministries and Customs and Excise Division (CED). However, year-on-year comparisons showed domestic revenue maintained strong performances as in previous quarters, improving by 4.3% against the same period a year ago. Consequently cumulative revenue to September exceeded the corresponding period of 2011 by 5% to $1,712 million.

IRD collection remains below budget as a result of overestimated projections by the authorities. However, the September quarter collections increased by 4.3% against the same period in 2011 to $361 million. Decomposing this into major categories, goods tax represented $162 million, PAYE tax $90 million, company tax at $57 million and withholding tax at $35 million, and the remainder was accounted for by other categories. Year-to-date collection by IRD improved 12% against the corresponding period in 2011 to $1,072 million. The key drivers were goods tax which rose by $66m over the same period in 2011 to $467 million, private sector PAYE that picked up $51 million to $224 million, and the $18 million rise in withholding tax to $224 million. Company tax, government PAYE and sales tax recorded marginal increases to $167 million, $56 million, and $44 million respectively. In terms of share to total IRD collection, goods tax gained 2 percentage points over the corresponding period in 2011 to 44%, private sector PAYE moved from a share of 18% to 21%, withholding tax increased from 9% to 10%.

Revenue collection from CED bettered June quarter to equal the average collection in the previous two quarters at $190 million. The September collection was an increase of 6% and 2% over budget and similar quarter of 2011. The CED categories that posted moderate increases over the previous quarter were export duties, import duties and logs. Export duties rose from $4 million in June quarter to $5 million, reflecting firm mineral prices. Import and log duties also went up in September, rising by 2% to $48 million and 0.8% to $97 million respectively while excise duties category was maintained at $39 million. Comparing to the same period a year ago, all major CED revenue components registered increases except for import duties. In the meantime, exemption on imported goods granted during the quarter dropped to $12 million from $15 million a quarter ago.

Year-to-September CED revenue increased by $60 million or 12% over the corresponding period in 2011 to $570 million. This reflects a general increase across all CED categories and is consistent with the growth in total trade. Decomposing the $60 million increase by major categories, log duties contributed $21 million, excise duties $18 million, $12 million from import duties and export duties $8 million.

Non tax revenue from other government ministries increased against the previous two quarters to $30 million. This resulted in a year-to-date collection of $71 million, constituting a massive under collection of 34% of the annual estimate. Major revenue collected during the quarter included $8 million from overseas fishing license, $5 million from fish sales, and light dues worth $3 million. During the quarter, grants amounting to $10 million from the Republic of China came through the Government's consolidated account mainly for capital development.

**Expenditure**

Total government spending fell sharply against the previous quarter by $57 million or 8% to $673 million, owing mainly to the large one off expenditure the government incurred as a result of hosting the eleventh Festival of Pacific Arts in the second quarter. The major drivers behind the above outcome were government goods and services expenditures and debt repayment.

Recruitment expenditure fell from $567 million in June quarter to $519 million this quarter. This comprise of Government spending on goods and services that dropped to $234 million from $301 million in the previous quarter. The fall reflected high FOPA related expenditures in the second quarter.

Decomposing this expenditure by key ministries, the Ministry of Education and Human Resources Development (MEHRD) accounted for $60 million (or 26%), Ministry of Health and Medical Services (MHMS) with $32 million (14%), and the Ministry of Police and National Security (MPNS) $20 million (or 8%). The next tier of major spending ministries comprised of Ministry of Provincial Government, Ministry of Culture and Tourism and Office of the Prime Minister with $13 million, $12 million and $11 million respectively.

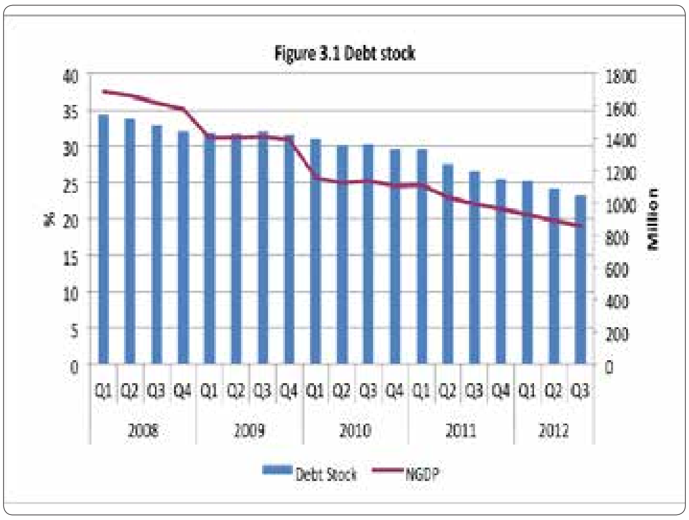
Spending on payroll in the third quarter was $164 million. In terms of share by large ministries, MEHRD represented $66 million (40%), MHMS at $34 million (21%) and MPNS $15 million (9%). Year-to-date payroll charges increased to $501 million, accounting for 77% of the annual payroll budget. At the current rate, payroll is likely to exceed the annual payroll budget by end year. Compared to the same period last year payroll spending was 6.5% higher, consistent with the previous two quarters performances.

Capital spending was $161 million, bringing year to September spending to $362 million. Of the amount spent on capital development during the quarter, the Solomon Islands Government accounted for $142 million whilst $18 million was attributed to donor funds received through the Government's consolidated account. Major capital payments made by the Government during the quarter included $20 million being for the FOPA preparation in July, $9 million in rural constituency development fund, $7 million for rehabilitation of coconut plantations and $6 million was for support in the cocoa sector. Although third quarter expenditure was 1.5% lower than the previous quarter's spending, it was 54% higher than the same quarter in 2011. The year to September spending accounted for 42% of the original estimated spending for 2012.

**Public Debt**

Public debt stock dropped 4% against the previous quarter to $1,050 million as a result of parallel drops in both the external and domestic stock, falling by $5 million and $38 million to $800 million and $250 million, respectively. The outstanding debt stock represented 18.7% of GDP, a slight improvement from 19.5% in the previous quarter.

Total debt repayment amounted to $50 million during the quarter. This composed of $10 million in external debt and $40 million in domestic debt. On the external repayments, principle repayments accounted for $8 million and interest repayments at $1.8 million. The external debt servicing was 25% above the original repayment schedule. External loans that were repaid in the quarter included $4 million each to World Bank and Asian Development Bank, $2 million to the European Investment Bank, $0.3 million to Republic of China and $0.1 million to European Union.




The 13% decline in domestic debt stock to $250 million was largely due to a $28 million payment on restructured bonds, which included upfront payment made by the Government in an attempt to quickly reduce its debt level and almost $8 million payment to SIG loans and advances with CBSI. The domestic debt repayment made during the quarter was almost four times higher than the scheduled repayment amount for the period.

## 4. BALANCE OF PAYMENTS

Solomon Islands balance of payments (BOP) posted a surplus of $67 million in the third quarter against the revised surplus of $120 million in the previous quarter. The smaller net surplus emanated from both a growth in the primary income account deficit and a drop in the secondary income account surplus. On the contra-side, the financial account registered a surplus of $48 million, compared to a larger revised surplus of $224 million in the second quarter. The slow external performance over the past two quarters reflected the concerns about the global market conditions.

**Table 4.1**
**Balance of Payments Statistics Summary**

(SBD'million)

| | 2011 | 2012 | | |
|---|---|---|---|---|
| | Q4 | Q1 | Q2 | Q3 |
| **Current Account** | | | | |
| Balance on Goods and Services | (31) | 76 | (182) | (55) |
| Trade in Goods | 37 | 165 | (60) | 16 |
| Exports | 864 | 962 | 846 | 949 |
| Imports | 827 | 796 | 906 | 933 |
| Trade in Services (net) | (68) | (89) | (121) | (70) |
| Primary Income (net) | (114) | (95) | (59) | (109) |
| Secondary Income (n et) | 192 | 208 | 260 | 114 |
| Balance on Current Account | (48) | 190 | (20) | (50) |
| Capital Account | | | | |
| Balance of Capital Account | 160 | 76 | 101 | 117 |
| Net Lending(+)/Borrowing(-) from Current and Capital Account | 208 | 265 | 120 | 67 |
| Financial Account | | | | |
| Net Lending(+)/Borrowing(-) from Financial Account | 153 | 273 | 224 | 48 |
| Net errors and Omissions | 55 | (8) | (104) | (19) |
| Level of Official Reserves at end of period | 3034 | 3280 | 3507 | 3613 |

Source: Central Bank of Solomon Islands

Given this, after averaging a vibrant 9% growth over the past three quarters, the level of gross foreign reserves in the September quarter has increased only slightly by 3% to $3,613 million. Nevertheless, this level is sufficient to cover 9.4 months of retained imports of goods and services.

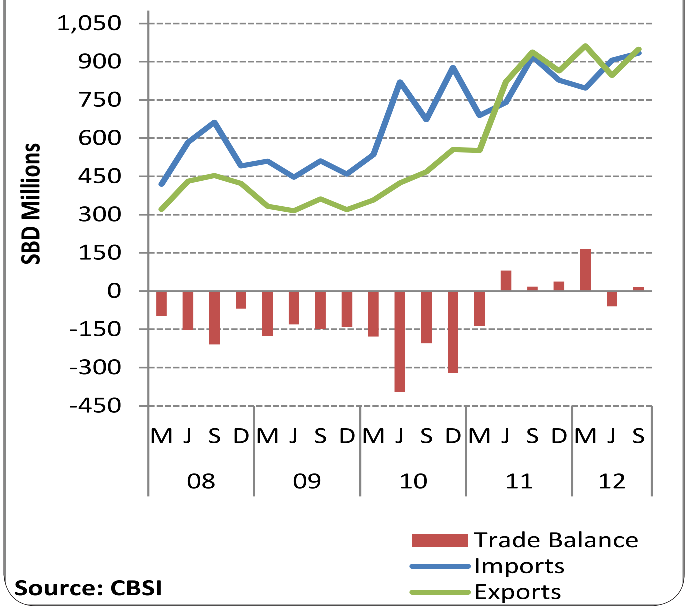
### Current Account

The current account balance slid to a deficit of $50 million from a revised surplus of $20 million in the previous quarter. This outcome was due to the declines in the donor denominated secondary income credits combined with some deterioration in the primary income deficit. On the other hand, the goods and services accounts improved during the quarter.

### Trade in goods

The trade in goods account recovered from the revised $60 million deficit in the second quarter to a trade surplus of $16 million in the third quarter. This turnaround came from a 12% increase to $949 million in exports that more than offset a 3% rise in imports to $933 million.

**Figure 4.1**
**Merchandise Trade**




Source: CBSI

The buoyant export performance in the September quarter came from two of the country's major export commodities, logs and fish. Log export receipts jumped 22% to $431 million due to larger shipment volumes as opposed prices, which have been falling. Processed timber exports also rose by 10% to $28 million. Fish exports spiked up to $170 million from $40 million, amidst favourable fishing conditions, cannery output and rising global fish prices. However, other major export commodities slumped during the quarter. Mineral exports slid 18% to $184 million due to weaker than anticipated output. Palm oil export receipts decreased by 27% to $59 million due to falls in international prices and export volumes. Copra exports fell 21% to $31 million due to lags in export shipments during the period. Other exports also slid 6% to $7 million and re-exports dropped to $16 million from $36 million.

The slight improvement in imports during the quarter came from higher imports of consumption, immediate and investment goods. Specifically, increases were noted from machinery and transportation equipment payments rising by 3% to

$260 million, food imports up 21% to $202 million and chemical imports jumped to $96 million from $62 million. Crude materials also increased to $12 million from $8 million and 'animal, vegetable and oil fats' rose to $4 million from $3 million. However, imports of mineral fuels slid by 2% to $242 million due to lower import volumes amidst rising oil prices during the period. Basic manufactures also dropped 17% to $137 million. Miscellaneous goods imports decreased by 19% to $52 million and 'beverages and tobacco' slumped by 39% $10 million.

**Trade in Services**
The services account improved significantly in the third quarter to net deficit of $70 million from a net deficit of $121 million in the previous quarter. This improvement in the structural deficit was partly due to the one-off impact of the Festival of Pacific Arts (FOPA) that led to the jump in services credits amidst a decline in services debits.

Services credits improved by 15% to 259 million. This buoyant outcome stemmed from travel inflows rising by 19% to $142 million. In particular, personal travel receipts jumped to $90 million from $62 million due mainly to FOPA and major travel related activities during the three month period. Transport inflows also contributed to the services credit with slight 3% rise to $58 million, of which sea transport increased by 12% to $22 million, and air transport slightly dropped by 2% to $36 million. Financial services inflows also increased to $20 million from $12 million together with an expansion in 'personal, cultural, and recreational' services of 9% to $29 million. However, telecommunications receipts dipped negligibly to $6 million whilst government services receipts dropped to $2 million from $4 million.

Services debits declined during the quarter by 5% to $330 million. This development emanated from large falls in outflows of 'other business' services by $15 million to $60 million, Government services payments which dropped by $14 million to $4 million, telecommunications by $4 million to $8 million. Construction and 'maintenance and repair' were down negligibly to $3 million each respectively. On the other hand, travel outflows rose by 5% to $116 million on the back of a 9% increase in personal travel payments to $71 million. Transport outflows increased by 6% to $109 million due to a 5% expansion in sea transport payments to $89 million, and an 11% rise in air transport payments to $20 million. Charges for the use of intellectual property jumped to $4 million from $1 million. Insurance services outflows also increased by $1 million to $18 million. Financial services payments and 'personal, cultural and recreational services' recorded negligible increases to $3 million and $1 million during the period.

**Primary Income**
The primary income account deteriorated to a deficit of $109 million in the third quarter from a revised deficit of $59 million in the previous quarter. This outcome was attributed to a significant fall in primary income credits and a jump in primary income debits.

Primary income debits rose 29% during the quarter to $140 million. This was due to a significant upsurge of 31% in investment income outflows to $131 million. This strong movement in investment income outflows primarily came from direct investment payments (such as dividends and reinvested earnings) that rose 88% to $102 million. However, other investment payments (such as interest on debt instruments) fell 36% to $30 million during the period.

Primary income credits fell 37% to $31 million. This came on the back of falls in 'other primary income' receipts to $1 million from $23 million, attributed to the one-off fishing licences payments in the previous quarter. Compensation of employee receipts also dropped to $2 million from $3 million. On the other hand, investment income receipts rose 21% to $29 million during the quarter. This was due particularly to interest income from reserve assets that surged by $5 million to $19 million.

**Secondary Income**
The secondary income surplus fell in the third quarter to $114 million from $260 million in the previous quarter. This development resulted from a considerable decrease in donor denominated secondary income credits amidst a moderate drop in secondary income debits. Secondary income credits declined to $190 million from $349 million, principally due to the drop in transfers to general government from $293 million to $142 million during the quarter. In particular, the fall in grants came from the 19% drop in Technical Assistance (TA) transfers to $122 million, and a sizable fall in aid in cash transfers to $11 million from $135 million in the previous period. Aid in kind on the other hand, rose by 24% to $9 million. Meanwhile, transfers from the private sector also fell by $8 million to $48 million, owing to 'other current transfer' inflows that decreased by a similar magnitude to $20 million.

Secondary income debits went down by 14% to $76 million. This was due to private sector transfer outflows also falling by the same magnitude. This takes into account transfer outflows from foreign workers' remittances and other personal transfers to parties overseas.

**Capital Account**
The capital account rose by 17% to $117 million in the third quarter. This was mainly due to capital transfer inflows to general government and reflects capital aid projects provided by development partners to the country during the period.

**Financial Account**
The financial account posted a surplus of $48 million in the third quarter, a deterioration from the revised surplus of $224 million in the second quarter. The result reflects a slowdown in the flows of financial assets counteracting the reduction in the flows of financial liabilities during the quarter.
Financial asset flows declined from $368 million to $87 million owing to the reduction in reserve asset flows to $98 million from $286 million in the previous quarter. In particular, the weaker reserve asset flows broadly reflects the decline in donor cash grants in the secondary income account. Portfolio investment assets also declined to negative $1 million from $1 million, and other investment assets posted a negative $14 million from $78 million in the previous period. On the other hand, direct investment assets rose remained flat at $4 million. By financial instrument, the financial assets outcome reflects a drop in debt instrument flows to $84 million from $364 million, and 'equity and investment fund shares' to $3 million from $5 million.

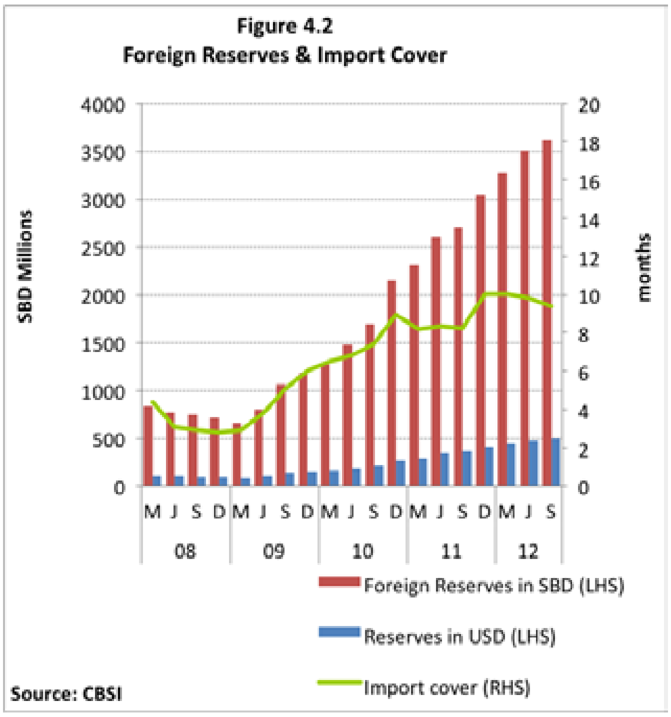
The financial liabilities fell to $39 million from $144 million due to falls in all major categories. Other investments posted a negative $46 million from $36 million in the previous period reflecting external loan repayments outflows that offset external debt inflows. Direct investment liabilities meanwhile, dropped by 20% to $86 million. The fall in direct investment inflows was driven by a 46% drop to $25 million in new foreign direct investment inflows and a decline to $5 million from $9 million in debt instruments from direct investors. This more than offset a 7% rise in reinvested earnings by direct investors to $56 million. By financial instrument, the financial liabilities inflows represents an 18% decrease in the inflow of 'equity and investment fund shares' to $81 million, and negative $42 million in debt instruments from $46 million in the previous quarter.

**International Investment Position**
The international investment position (IIP) is a statement of the country's external stock of financial assets and liabilities, and reflects a country's economic relations with the rest of the world. In the third quarter, the IIP posted a 'net borrowing' outcome of $5,499 million, a 3% improvement from the 'net borrowing' of $5,688 million in the previous period. This outcome emanated from both a rise in financial assets and a drop in financial liabilities.

Financial assets increased by $94 million to $4,646 million. The rise in the stock of assets stemmed from reserve assets which increased by $106 million to $3,613 million to outweigh marginal falls in portfolio investment and other investment. Direct investment assets also posted an increase of $4 million to $257 million.

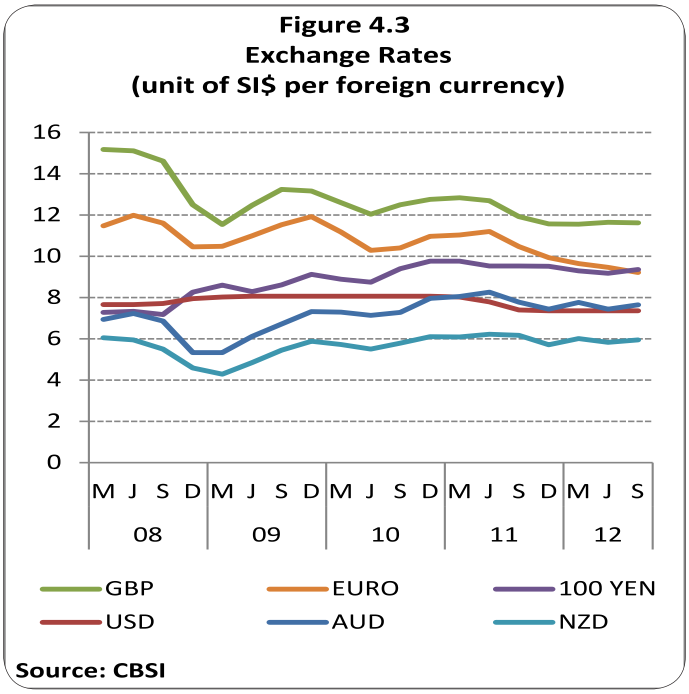
The stock of financial liabilities meanwhile decreased marginally by $94 million to $10,145 million. This originates from a 5% drop in the stock of other investment liabilities to $3,487 million, particularly from external debt repayment during the period. Portfolio investment liabilities also declined insignificantly to $3 million. On the other hand, the stock of direct investment liabilities rose by $86 million to $6,654 million.

**Foreign Reserves**
The gross foreign reserves at the end of the third quarter rose 3% to $3,613 million. This outcome was due to higher export receipts and donor inflows during the quarter offsetting higher import payments in the same period. Exchange revaluation gains of $8 million also contributed to the increase. This level of reserves was equivalent to 9.4 months of import cover.




### Exchange rate

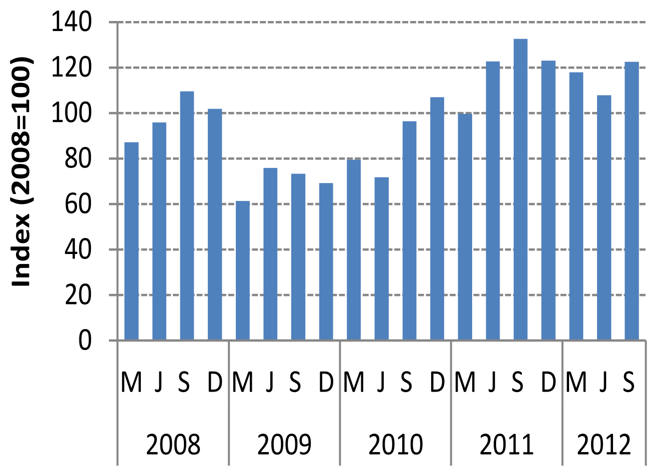
The Solomon Islands dollar (SBD) remained pegged against the United States dollar at $7.36 per USD during the quarter. On average, the SBD depreciated by 2.7% against the Australian dollar to $7.64 per AUD, 1.9% against the Japanese yen to $9.36 per 100JPY, 2.1% against the New Zealand dollar to $5.95 per NZD. The SBD, however, appreciated by 0.3% against the British pound to $11.62 per GBP, 2.6% against the Euro to $9.21 per EUR.



## 5. DOMESTIC ECONOMY

Domestic activities as indicated by the CBSI production index rebounded in the third quarter, rising by 14% to 123 points following consecutive declines in the past three quarters (see Figure 5.1). The upturn was driven by increases in fish, log and copra outputs that counteracted falls in palm oil, cocoa and mineral.

**Figure 5.1**
**Production Index of Major Commodities**



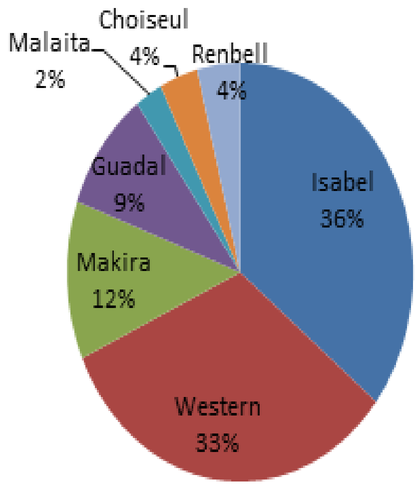

**Source: CBSI**

### Logs

Log production as proxied by export volumes bounced back by 15% in the September quarter to 509,504 cubic meters from 442,286 cubic meters in the previous quarter. This turnaround was consistent with the higher number of log shipments made in the quarter as against that in June quarter. Decomposing the log export volumes by provinces, Isabel province accounted for 36% followed by Western (33%), Makira (12%) and Guadalcanal (9%) while the other provinces accounted for the remainder (see Figure 5.2). Compared to the second quarter, all provinces recorded increased production except for Malaita, Choiseul, and Central provinces.

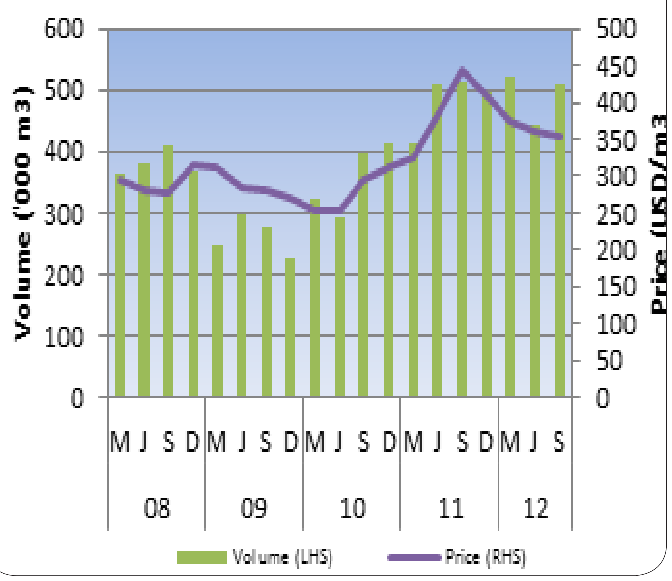
Log production in the nine months to September was 1,475,167 cubic meters, 3% higher than the corresponding period in the previous year. At the current extraction rate, log exports could exceed the annual output of 1.937 million cubic meters in 2011.

**Figure 5.2**
**Log Export by Province.**




The average international log price subdued for the fourth consecutive quarter, decreasing by 2% to USD355 per cubic meter from USD361 in the preceding quarter and was 20% lower than the same quarter last year (see Figure 5.3). The continued fall in international log prices reflected weakening Asian demand particularly from China since the beginning of the year.

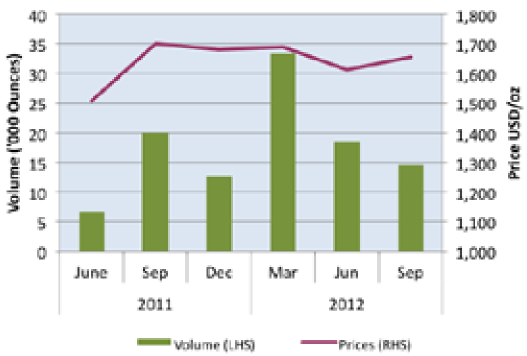
**Figure 5.3**
**Volume and Average Price of Logs**



**Mineral**

Gold production declined by 21% in the September quarter to 14,627 ounces from 16,845 ounces registered in the previous quarter. Production fell due to mechanical problems faced by the mill during the second and third quarter of the year which resulted in unscheduled maintenance and disruption to mill throughput. Gold production cumulative to September now stood at 66,583 ounces. The average quarterly international gold price increased slightly by 3% to USD1,656 per ounce from USD1,612 per ounce a quarter ago (see Figure 5.4). However, the end of quarter price in September strengthened to US$1,745 per ounce, the highest in twelve months.

Figure 5.4
Volume and Average Price for Gold




Silver production fell 19% for the second consecutive quarter to 4,964 ounces despite a slight price increase of 2% to USD30 per ounce during the quarter. The fall in output was related to disruptions to mill production at Gold Ridge. Like gold, price of silver at the end of the quarter was the highest since September 2011 at USD34 per ounce.

**Fish**

Fish catch increased considerably by 44% to 8,768 tons compared to 6,112 tons in the previous quarter. The positive outcome was due primarily to fishing vessels fully maximising their fishing days. This brings year-to-date production to 20,326 tons, slightly higher than the level in the corresponding period of 2011. The increased output enables the tuna industry to benefit from fish prices that was sustained throughout the year. The average international price of fish further strengthened by 11% to a historical high of USD2,347 per ton. The increase mirrored strong prices particularly in the months of August and September. The end of period price for September quarter was pitched at US$2,397 per ton.

With favourable fish catch and better prices, canned tuna production went up by 39% to 1,278 tons (158,421 cartons) from 920 tons (114,133 cartons) in the previous quarter. Exports of canned tuna increased by 11.5% to 161 tons (19,925 cartons) compared to 144 tons (17,875 cartons) recorded in the second quarter. This has resulted in domestic canned tuna sales to decline by 26% to 709 tons (87,894 cartons), in contrast to 953 tons in the previous quarter. Canned tuna production cumulative to September reached 3,129 tons (388,056 cartons), 21% higher than the same quarter of 2011. Production of fish loin for export increased significantly by 88% in the third quarter to 2,349 tons in contrast to 1,257 tons in the second quarter. The positive outcome this quarter benefited from the double shift arrangement at the Noro cannery and was a timely response to the strong fish prices this year.

**Copra**

Copra output rebounded in the third quarter, rising by 17% to 7,440 tons in contrast to the 29% decline in June quarter. The strong performance was attributed to a positive response by local copra farmers to the brief price increase in the month of August and the freight subsidy that some copra buyers introduced as an incentive during the quarter. Decomposing the quarterly output by provinces, Guadalcanal province had the largest share with 2,416 tons (34%), followed by Central province with 1,749 tons (25%), Malaita province 864 tons (12%), and other provinces with less than 10% each.

Year to date production fell by 15% against the corresponding period in 2011 to 22,749 tons. The contraction was explained by the weak copra prices in 2012. Average contract prices for local exporters declined further by 8.5% to USD550 per ton. Consequently, average domestic prices declined for the second consecutive quarter by 10% to $2.85 per kilogram (see Figure 5.5) with an end of quarter price of $2.67 per kilo.

Despite improved output, estimates of total income earnings for local copra farmers showed a slight drop to $21.4 million from $21.6 million in June quarter. The fall in income earning was driven largely by the weak copra prices this quarter. Meanwhile, year on year comparisons showed earnings improved against the $20.8 million estimated for the corresponding quarter of 2011.

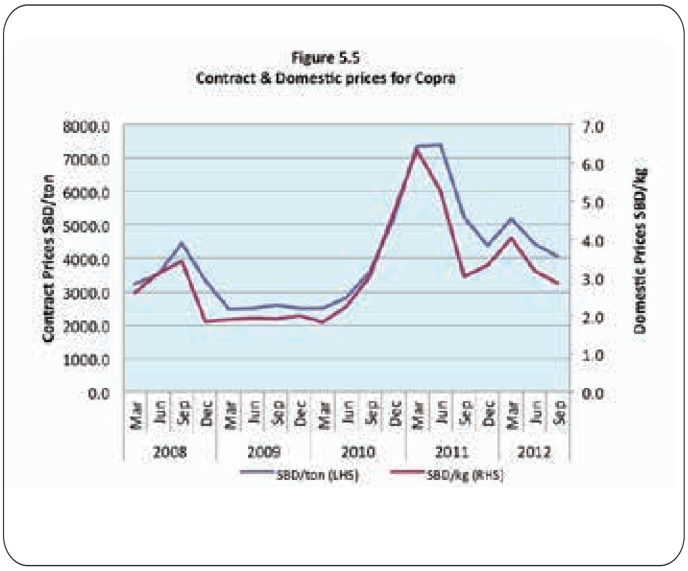



Figure 5.5
Contract & Domestic prices for Copra

**Cocoa**

Cocoa production plummeted by 61% over the quarter to 851 tons from 1,829 tons in the previous quarter and 64% lower than the corresponding quarter a year ago. Year-to-date production now reached 3,310 tons, but still 35% below the same period in 2011. Disaggregating the quarterly output by provinces, Guadalcanal had the largest output share of 242 tons (34%), followed by Makira with 240 tons (34%), and Malaita 27% (196 tons). The other provinces accounted for the remaining 5% (38 tons).

The contracted export and domestic prices for cocoa trended upward to record the highest since the beginning of the year. Export price rose by 3% to GBP1,334 per ton while the domestic price increased by 5% to $12.20 per kilogram. Despite surging prices, income earning for local cocoa farmers was halved to $10.3 million from $21.3 million in June quarter, owing mainly to the cyclical fall in output.

**Palm Oil**

Palm oil output slipped 13% over the quarter to 7,783 tons, as opposed to the 24% increase in the second quarter. Palm kernel oil also dropped against the previous quarter by 19% to 816 tons and 13% below the same quarter a year ago.

However, palm kernel oil contracted by 2% against YTD 2011 to 2,591 tons as a result of the weak output in the current quarter.

Year-to-date palm oil output grew by 2% against the corresponding period in 2011 to 23,964 tons, benefiting from the large increase in the second quarter this year.

The average international price for palm oil remained low this quarter, falling by 9% to USD995 per ton. The falling prices were driven mainly by significant stockpiling in major palm oil producing countries such as Indonesia and Malaysia coupled with the weak demand for food and biodiesel products as a result of the global economic down turn. The average price for palm kernel oil also fell by 18% to USD1,021 per ton, the lowest recorded since 2010.

**Employment**

Partial labour market indicators showed an improvement in the third quarter. The average number of Solomon Islands National Provident Fund (SINPF) contributors in the third quarter improved slightly to 46,567 from 46,196 in June quarter. Compared to September 2011, this was a year on year growth of 8%. Active contributors expanded by 2% over the quarter to an average of 40,353 contributors from 39,526 contributors in the June quarter. Compared to the same period of 2011, active contributors went up by 15%. The slow active category which accounted for 6,213 contributors fell by 7% against the previous quarter and 20% against September 2011.

According to the CBSI job advertisement survey, a total of 476 job vacancies were advertised this quarter[1] compared to 338 job vacancies registered in the previous quarter. Education sector accounts for the highest with 131 vacancies (28%), followed by non-governmental agencies with 77 vacancies (16%), transport and agriculture sectors with 37 (8%) and 27 (7%) vacancies respectively, whilst vacancies for the remaining sectors represent less than 5% in the third quarter.

**Energy**

Units of electricity generated by Solomon Islands Electricity Authority (SIEA) rebounded in the third quarter, rising to 19,200 Megawatt hours (MWh) from 18,284 MWh in the second quarter. Consequently, cumulative units of electricity generated up to September rose by 0.5% above the corresponding period of 2011 to 55,897 MWh.

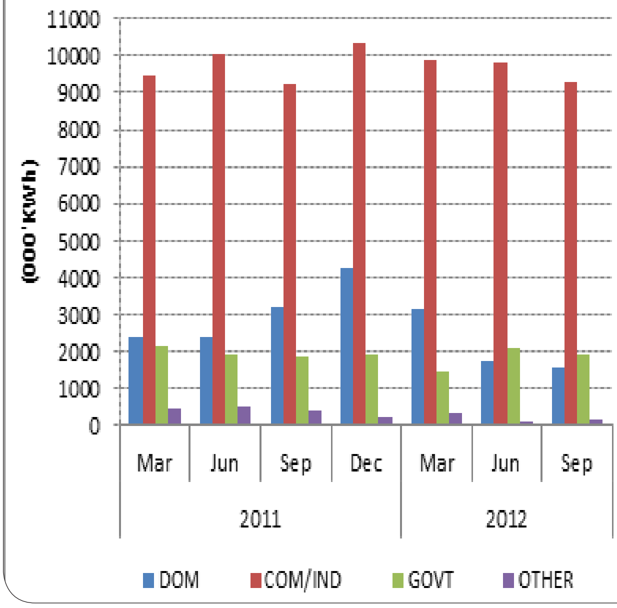
However, units of electricity sold fell by 6% to 12,945 MWh from 13,735 MWh in the previous quarter. As depicted in Figure 5.6, sales to domestic households declined further by 10% to 1,558 MWh, commercial and industrial users down by 5% to 9,281 MWh, and sales to Government offices fell by 8% to 1,907 MWh. Units sold to other categories, on the other hand, increased to 199 MWh from 111 MWh in June

1 Local Newspaper, Solomon Star

quarter. Comparing to the corresponding period of 2011, electricity sold to domestic and other users fell by 52% and 49% respectively. Although sales to government and industrial categories increased slightly, cumulative units of electricity sold to date fell by 6% against the same period in 2011 to 41,491 MWh.

Unsold units of electricity rose 37% against the preceding quarter to 6,255 MWh. As a result, the ratio of unsold units to generated units worsened further from 25% in the previous quarter to 33% this quarter.

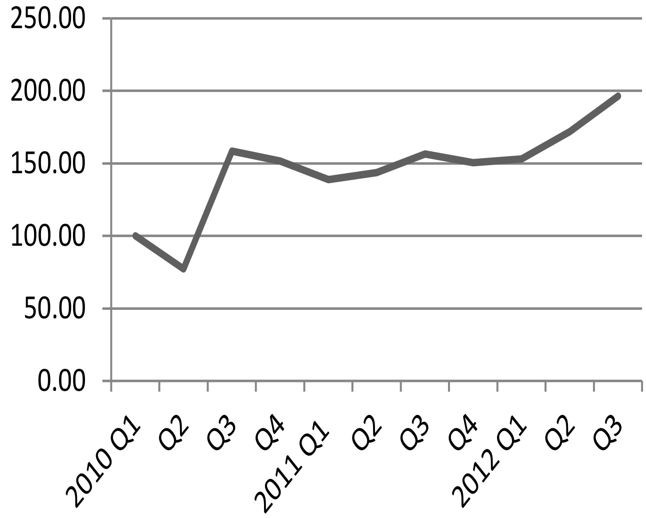
Figure 5.6
Units of Electricity Sold




**Manufacturing**

The CBSI manufacturing index representing both domestic and exported goods showed an increase of 14% over the quarter to 196, driven by a significant increase in tuna products for export. However the manufactured products destined for the domestic market dropped slightly during the quarter. The decline was due to an 18% fall in soft drinks and alcohol beverages and 4% fall in tobacco production over the quarter. Compared to a year ago, the overall manufacturing index was higher by 26%, reflecting similar results in both the imported and domestic indexes.

Figure 5.7
CBSI Manufacturing Index




**Foreign Investment**

Foreign direct investment applications declined slightly to 40 applications during the quarter from 41 applications registered in the previous quarter. Mining, forestry and retail & wholesale sectors accounted for 7 applications each, followed by other services with 6 applications for real estate, business consultancy and business advisory services. Against the previous quarter, investment applications for all major categories increased except for other services and transport sectors which fell to 6 and 2 applications from 15 and 4 applications respectively.

In terms of provincial distributions[2], Honiara accounted for 30 applications; Western province with 22 applications, Choiseul 21 applications, Guadalcanal and Isabel with 20 applications each while Malaita, Central, Renbel, and Makira and Temotu provinces with 19 applications each.

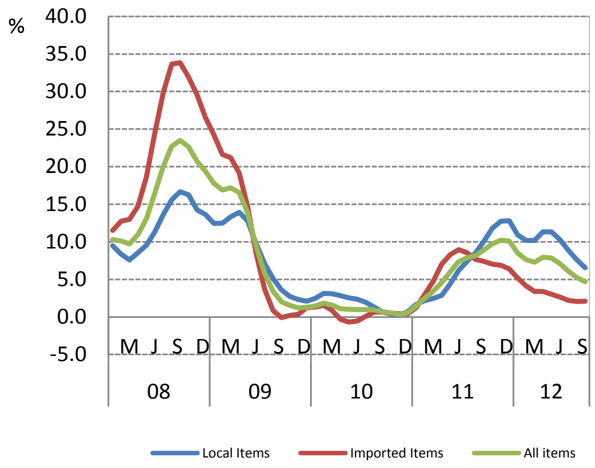
A total of 139 investment applications were recorded to date, 25% above the corresponding period of 2011. However, the total value of these investment applications dropped almost twice, 82% lower than the same period last year.

2 Foreign investors indicated in their applications that they will operate in more that one province. Therefore the provincial distribution will not tally up to the 40 foreign investments applications that were recorded in the quarter.

**Inflation**

Headline inflation eased further to 4.7% from 7.1% in the previous quarter. The fall was attributed to a slowdown in prices for both imported and domestic goods during the quarter. The former declined from 2.7% to 2.1% whilst the latter eased from 10.3% to 6.6% at the end of the September quarter.

Figure 5.8
Honiara Retail Price Index
Three month moving average (3mma)




The imported inflation was driven by falls in food, clothing & footwear and transport & communication components. Similarly leading the fall in the domestic inflation were food, drinks & tobacco, household utilities and household operations.

Average domestic fuel price movement this quarter slowed down, falling by 7% to $11.26 per litre from $12.08 per litre in the previous quarter reflecting the decline in the major fuel categories. The average price for diesel went down to $10.75 per litre from $11.79 per litre in the second quarter, average petrol price fell to $10.45 per litre from $11.80 per litre while kerosene declined slightly to $12.59 per litre from $12.66 per litre in the previous quarter. Against the same period in 2011, fuel prices fell by 9%.

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