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Inflation in Solomon Islands

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The Central Bank of Solomon Islands like many central banks, aims to maintain low and stable inflation or 'maintain price stability' as part of its primary objective. This article seeks to talk about inflation, sources of inflation, effects of inflation as well as what CBSI does to manage inflation.

What is inflation?
Inflation is the rate of increase in the overall level of price of goods and services in an economy over a given period of time.

Note that inflation is not about just the increase in price of one good but rather of a large basket of goods and services typically consumed by a household. This basket of goods and services contain consumer items such as food, transport & communication, drinks and tobacco, housing operations whose price movements are weighted and combined to determine the overall change in the inflation rate over a period of time.

Causes of inflation

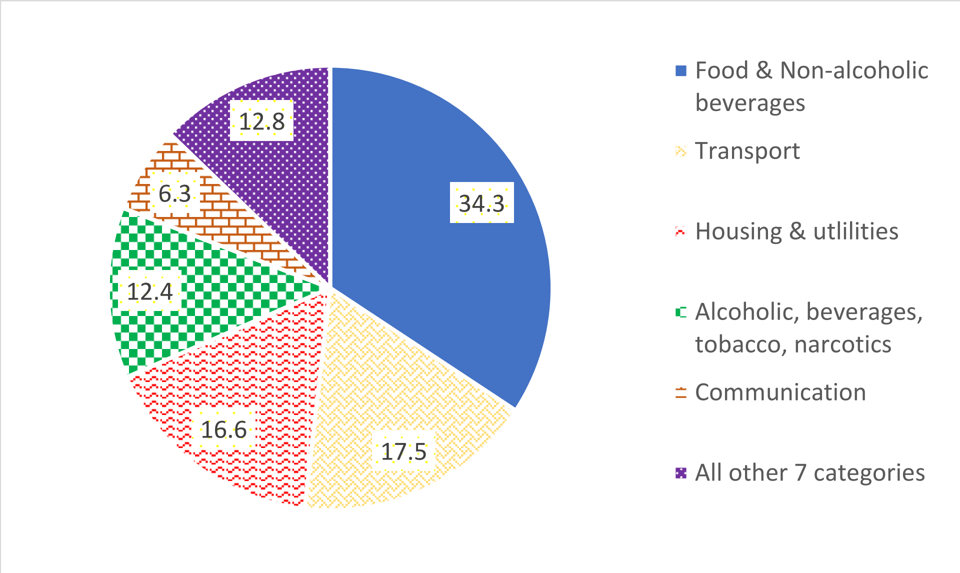
The primary cause of inflation is when there is too much money available to buy limited goods and services. Inflation can also be caused by supply and demand factors. **Supply shocks** caused by disruptions in production (such as from natural disasters) or **higher production costs** such increase in wages, rent or oil/fuel price may lead to ''**cost push inflation"** as these factors limit the supply of goods and services produced. For example, external shocks caused by significant events like the Ukraine Russia War will affect the supply of oil. This tends to increase the price for fuel overseas and in the country.

Similarly, d**emand pull inflation** can result from policies (such as increased government spending) that lead to higher demand for goods and services that exceed an economy's production capacity.

How is inflation measured?

Inflation is a broad measure and is typically calculated as annual percentage change in Consumer Price Index (CPI). The Solomon Islands National Statistics Office (SINSO) is tasked with the mandate of measuring the country's inflation rate. It conducts a monthly survey to measure changes in prices of a fixed basket of goods and services typically consumed by consumers. This is then used to calculate CPI which is classified into twelve categories and assigned weights based on consumption patterns identified in a separate survey called the Household Income & Expenditure Survey (HIES) (Chart 1).

Chart 1: CPI weights by category (%)

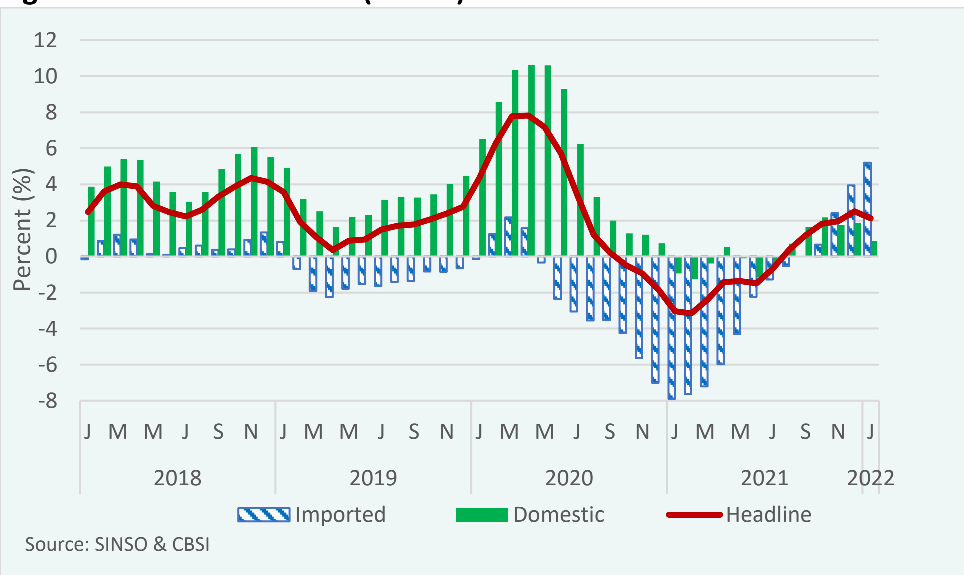


Source: SINSO

Headline inflation trend

The latest national headline inflation eased to 2.1% in January 2022 from 2.5% at end of December 2022 (Figure 1). The outcome was driven by the slow-down in domestic inflation in January to 0.9% from 1.9% in December. In contrast, imported inflation surged to 5.2% in January from 4% in the prior month reflecting the price increases in imported food a and fuel items over the period.

Figure 1: National inflation (3mma)



What are the effects of inflation/impact of inflation?

Inflation is both good and bad depending on how much there is.

On the positive side, little/small inflation can help to promote economic activities or increase production activities, contributing to overall growth in the economy. For example, a producer may see an increase in price of a good or service as a way to earn more money, the producer is encouraged to invest more and hire more people to increase production of that good/service.

On the negative side, too much inflation is not good for the economy. The following reasons are why too much inflation is not good for the economy

- Firstly, when price increases ***purchasing power decreases causing real income to fall****:* this means that as wages and income stay the same, your purchasing power falls meaning that you will purchase less goods for that same amount of money. This makes you relatively poor as your ability to purchase the same amount of goods falls.
- ***Income redistribution:*** When prices increase sharply a consumer/business may face the economic choice of having to prioritize expenditure on important needs/items. For example, when prices increase, and a consumer's income stay the same, a consumer may forego the purchase of new clothes to meeting food for the week or an outstanding monthly water bill.
- ***Wage inflation can harm businesses:*** High inflation can lead to an increase in wages as people look to protect their real incomes. This can lead to a rise in unit labour costs and lower profits for businesses.
- ***High domestic inflation can increase cost of local exports:*** High inflation can make our country's exports expensive leading to lower demand for its exports.

On the other hand, too much deflation is also not good for the economy. Deflation refers to the reduction in the general level of prices in an economy. A continuous deflation may hurt the economy as consumers may halt spending in anticipation that prices will reduce further and producers too may be discouraged to produce goods and services from lower price and slower sales. A combine effect of reduce spending and fall in production can weaken the economy.

Relevance of Inflation for CBSI

Unlike other countries, the CBSI does not have a formal inflation target rate compared to countries such as Australia and New Zealand. As a Small open economy highly vulnerable to both domestic and external shocks, Solomon Islands closely monitors the country's inflation rate and ensures that it is broadly contained within a single-digit range. The Central Bank conducts monetary policy to achieve its primary objective of maintaining price stability.

Monetary policy refers to the tools used by the Central Bank to achieve its objectives through exchange rate and quantity of money available to the public to control demand**.**

Overall i**nflation** is an important economic indicator that affects our economy for which CBSI monitors regularly. Inflation affects the value of money which has a direct impact on the livelihood of consumers and the operations of businesses. Ideally, a stable and low level of inflation is important for our economy in supporting a stable cost environment that protects people's income & wealth, promotes sound planning and allocation of resources. All of which contributes to sustained economic growth for Solomon Islands.

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Disclaimer: The views and opinions expressed in this article are those of the author and do not reflect those of the Central Bank of Solomon Islands.