Statement by CBSI Governor, Dr. Luke Forau at the launch of the 2019 CBSI Annual Report, on 13th May 2020

Salutations & Acknowledgements

1. Introduction

Fellow Solomon Islanders, ladies and gentlemen, welcome to the soft-launch of the Central Bank of Solomon Islands Annual Report for 2019. Due to the coronavirus (or for short COVID-19) containment measures, it is regrettable that we won't be launching this report in the normal way we used to do. Instead, we are launching this report in this virtual space.

The CBSI Annual Report is one of the key events in the Bank's calendar, where we highlight the economic performance of the country, and outline last year's operations of the Bank. Also, I will share some insights into how we may need to move forward in terms of developing our economy.

But first, at the outset, I would like to add that this is my first annual report launch as Governor of the Central Bank of Solomon Islands (CBSI).

As such, I would like to acknowledge my predecessor, Mr. Denton Rarawa for his great leadership of the institution over the past eleven years.

The theme for my statement today is "preparing for a new normal amidst covid-19 and harnessing the opportunities for economic recovery". This topic is quite relevant and befitting to our current situation where we are living in a climate of uncertainty and economic prospects are bleak. Nonetheless, the country has always been resilient, as evidenced in the past, so I believe we can utilize the opportunities that come with the economic recovery to build a better Solomon Islands.

2. Solomon Islands Economy in 2019

First, let me turn to the developments in the economy over the past year. The Solomon Islands Economy slowed down in 2019, with real GDP growth estimated at 1.2%. This is lower than the 3.9% growth in 2018. This outcome was attributed to very sluggish global market conditions and weaker domestic demand.

On the domestic front, the slowdown was seen in almost all sectors. There were falls in the commodities sector, particularly from agriculture and logs, a very flat secondary sector related to the decline in manufacturing, and a slowdown in the services sector.

It is worth noting that most of our primary commodities declined in 2019, except for fish catch and cocoa. As anticipated, total (natural and plantation) log production dropped by 2% to 2.68 million cubic metres due to weak demand from China. Similarly, output for palm oil, copra and coconut oil also declined, owing mainly to fallen international prices during the year.

The fall in commodities ultimately affected the country's external sector. As a result, the trade in goods and services balance decreased to a deficit, resulting from declining exports, coupled with a rise in services payments. This led to a deterioration in the current account deficit. To finance this deficit, the gross foreign reserves declined by 6% to $4,706 million. At this level of reserves, it is equivalent to around 11 months of import cover.

Reflecting the subdued economic environment, monetary conditions weakened in 2019. Broad money declined by 3% to $5 billion due to the fall in net foreign assets. Total liquidity, along with excess liquidity both fell, although both remain at elevated levels. On the other hand, credit offered by banks increased by 5% to $2,557 million driven by borrowings to the personal, transport, distribution and construction sectors.

Fiscal conditions likewise, saw a reversal in the fiscal outcome, with the fiscal balance turning to a deficit of $202 million from the $191 million surplus recorded in 2018. Government revenue declined by 11%, stemming mainly from the downturn in logs, donor grants, as well as declines across most tax categories reflecting the weaker business conditions. Government expenditure however, fell by only 1%, reflecting mainly underspending in the development budget.

Government debt level, on the other hand, remained at a sustainable level of around 11% of GDP.

Despite the weaker macroeconomic conditions, employment indicators remained positive during 2019. Proxy indicators from the Solomon Islands National Provident Fund showed contributors grew by 3% to 60,643 members. Similarly, public service positions also rose by 2% to around 18,000 employees. Moreover, there were also temporary employment opportunities for the national elections and the national census. There was also an increase in seasonal workers to Australia and New Zealand, and contracted nurses to work in Vanuatu.

In terms of inflation, consumer prices remained at an acceptable level during the year. The end period headline inflation for December 2019 was 2.8% compared to the 4.2% in December 2018. The drop was driven by the falls in both the import and domestic prices, especially price falls for food, fuel, clothing and restaurants, while prices for betel nuts and utilities picked up. Meanwhile, annual average core inflation in 2019 levelled off at 1.6% as in 2018; this indicated that demand side pressures on consumer prices were minimal.

3. Economic Outlook

Looking ahead, the outlook for the Solomon Islands economy this year is quite bleak. Although Solomon Islands is still COVID-19 free, the impact of our preparedness against this pandemic on our economy, has taken a toll on our projected growth for this year.

As a result, for 2020, economic growth is projected to contract to around minus 5%. Given the uncertainty surrounding the COVID-19 pandemic, the country's external and domestic environments will continue to be affected by the health containment measures and the weak consumer demand. Sectors that we have already seen been affected and will continue to be affected significantly include tourism, transport, wholesale retail, manufacturing, agriculture and forestry.

As already highlighted in our previous media release, the economy will go into recession by the second quarter of this year.

Furthermore, the uncertainty surrounding the duration and magnitude of the COVID-19, let alone our continuous preparedness and containment measures, will continue to have negative impact on the economy.

However, over the medium term, growth is expected to return to an average rate of 3.5%, as key infrastructure and development projects are implemented. In addition, the positive flow on effects of the post-covid-19 recovery and stimulus are expected to persist over the next couple of years.

4. CBSI Operations

Now let me turn briefly to the operations of the Central Bank for last year.

2019 was quite a successful year for the Central Bank. The Bank made a net operating profit of $93.9 million. And this came from the favourable global financial market conditions, particularly in the first half of the year, positive foreign exchange movements, as well as the strategic and tactical placement of our investment assets overseas. This led to CBSI's balance sheet improving significantly with net equity almost doubling, to $291 million at the end of the year.

In terms of the Bank's governance, the Board had a full complement of nine directors in the first part of the year. However, two directors left the Board in June and August. At this juncture, I would like to thank Sir Thomas Chan for his services to the CBSI Board. Once again, I would like to acknowledge the great leadership of my predecessor Mr. Denton Rarawa for his service as Governor of the Central Bank and as the Chairman of the Board.

As regards the Bank's staff compliment, the Bank implemented an institutional review in 2019, which saw total number of staff increased by 4% to 166. I am pleased to mention that CBSI is not only a national institution with most of our staff and management who are Solomon Islanders, but it is also an equal opportunity employer with a gender ratio of 55% male to 45% female. The Bank also strives to continuously enhance its human resources. During the year, 25 officers undertook academic tertiary studies, of which 11 completed their relevant tertiary qualifications.

With respect to currency operations, in May 2019, the Bank launched a new $5 polymer bank note that paid homage to the role of fishing to both subsistence food production and in the formal economy. The $5 polymer note is the last in our existing note series to be reformed. With the use of a sturdier polymer, it is expected to last longer compared to the heavily used old $5 paper note.

In terms of the financial sector, our domestic financial system remains stable, sound and prudently managed. Nonetheless, there are also issues that were highlighted in the Solomon Islands' Mutual Evaluation Report on our compliance to Anti-Money Laundering (AML) standards. And this includes the need for amendments to the relevant legislations, resourcing and addressing of AML issues related to non-financial sector groups like the professional bodies such as the Accountants, Lawyers, Real Estate Agents and others.

With regards to the financial inclusion space, a momentous stride was gained last year. In particular, the Bank worked with UNCDF-PFIP, SINPF and the two mobile telecommunication operators to roll out the use of mobile phones to use airtime top-ups as savings at the SINPF *youSave* savings product. I must say that this has been quite a success and it's the first of its kind in the world.

5. **"Preparing for a new normal amidst covid-19 and harnessing the opportunities for economic recovery"**

Now, going back to my theme; "Preparing for a new normal amidst covid-19 and harnessing the opportunities for economic recovery". Without a doubt, the country will face a lot of headwinds this year due to Covid-19. As I alluded to earlier, the uncertainties of the spread and duration of the pandemic has dampened economic activities in our country. Hence, authorities have to be more precautionary and strategic in their approach to ensure basic economic activities are maintained from further deteriorating. As a country, we need to keep domestic demand going. Hence economic activities within the domestic economy needs to continue, of course within the bounds of the health containment measures.

On this note, I would like to congratulate the Government for launching the $309 million stimulus package last week that would contribute to mitigating the impacts of Covid-19 on the economy and local businesses.

With this amount of stimulus, our preliminary estimates entail that in the short to medium term horizon the induced round of spending should increase aggregate demand by approximately $1.5 billion. However, the speed of this multiple effects will depend entirely where and how the stimulus is spent. That said, it is incumbent, and I am sure and confident that the stimulus goes to the right sectors and to the right businesses/people.

Looking ahead, perhaps this pandemic has brought us to a new normal. A new era that requires that we explore new ways of doing things. That is to do things differently, to be more creative and innovative to develop our country. These are not new ideas but if cultivated with vision, we can effectively utilize the opportunities that will arise once our economy recovers and realistically place our growth trajectory on a more inclusive and broad-based development path. And some of these opportunities include:

i. Building up our macroeconomic buffers. This is key to preparing for the next global shock, pandemic or disaster. At a personal level, one must also have savings tucked away for emergencies or during rainy days. Likewise, the country needs to rebuild its fiscal buffer (reserves), institute a capital development fund and maybe invest portions of income from the extractive industries into other innovative and renewable growth industries. These buffers would enhance the resiliency of our economy.
ii. Broadening our economic base because it ensures that the economy is firmer and more productive. It could also withstand direct shocks that affect certain sectors and industries. For instance, with Covid-19, there are opportunities for more domestic manufacturing and increase agricultural production that would broaden the economy, safeguard our food supplies and increase local employment opportunities.
iii. The Government must continue with its reform agenda of having policies that could innovate and spur business activity. This includes expediting the reforms in the tax regime, improving the ways of doing business, and using technology to boost commerce amongst others. Such reforms are important so that the country is competitive and kept abreast to the latest standards.
iv. Importantly, we must not forget that we must have inclusive growth and participation in economic activity. As part of a broadening of the economic base, encouraging new and niche agricultural crop production, as well as encouraging larger semi-commercial and cooperatives would spread activities to our rural populace. Moreover, consultative and participatory approaches to development are important for resource owners to feel and have ownership of projects and investments in their communities.
v. Finally, following from my last point above, there needs to be a refocus in the country’s development strategy. Perhaps, this is the opportune time ‘to do things differently’. Focus should

now be on developing the rural village. We've seen during the social unrest the 'village' was used as an insurance. Resilience was seen in the village. In fact, it was the rural economy that kept the country going during that unrest. Again, in this pandemic the village was used as an insurance. People were sent home for safety. I am very certain that the next economic crisis in the future, people will travel back to the village. What I am saying is that the village has been used by the majority of our people as an insurance (or as a fall back). If that is the case, then I seriously think there is a need for us to start the discussion on alternative paths to development. After 40 years of self-chatting our economic destiny, we are still no way near to an economy that can economically sustain its people. Ladies and gentlemen, Solomon Islands needs an alternative **development path** with alternative transmission channel(s).

As I said, these ideas are not new, but requires champions to initiate the process.

6. Conclusion

Before I conclude, let me re-emphasize what has already been published, that CBSI is adopting an expansionary monetary policy to support the government's response to Covid-19. CBSI's measures as announced by the Honourable Prime Minister during the Stimulus Package launch last week, broadly include CBSI being prepared to purchase government bonds on the secondary market. This would provide additional borrowing space for government, and liquidity for the lenders. Additionally, the Bank will be embarking on rolling out an export-import facility to assist businesses with their trading needs with opportunities for more competitive financing.

In closing, I would like to thank all our stakeholders; the government, the private sector, financial institutions, development partners and individuals, who have worked closely with us over the past year and I hope into this year. I would also like to express my gratitude to our auditors, the Office of the Auditor General and the contracted external auditor, PricewaterhouseCoopers (PwC) of Fiji. Finally, I extend my appreciation to my diligent CBSI board members, the management and the staff for their dedication and commitment to achieving the objectives of the Bank and for another successful year.

It is now my pleasure to commend the Central Bank of Solomon Islands' 2019 Annual Report for your reading.

Thank you and May God Bless Solomon Islands.

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