International Monetary Fund

Solomon Islands and the IMF

Solomon Islands: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

Press Release:
IMF Completes the First Review Under the Standby Credit Facility with Solomon Islands, and Approves Request for Modification of Performance Criteria
June 27, 2012

June 7, 2012

The following item is a Letter of Intent of the government of Solomon Islands, which describes the policies that Solomon Islands intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Solomon Islands, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

LETTER OF INTENT

Ref: RF457/5/5 June 7, 2012

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Ms. Lagarde,

Solomon Islands has benefited from its strong engagement with the IMF. The current one-year precautionary Standby Credit Facility (SCF) arrangement, approved on December 6 2011, after the previous SCF expired on December 1, has been instrumental in anchoring the government policy agenda. Economic recovery has been stronger than expected, the fiscal and external positions have improved, and donors' support has been catalyzed.

Given the observance of all end-December 2011 quantitative targets by large margins (Table 1), all continuous performance criteria, and the substantial progress in implementing the structural benchmarks (Table 2), we request the completion of the first review under the SCF arrangement and the modification of the end-June 2012 performance criteria. Because our external position remains healthy and reserve coverage is at a comfortable level, we do not expect to draw on IMF resources under the current arrangement.

We remain committed to reforms aimed at enhancing the resilience of our economy, promoting strong, sustainable, and inclusive growth, and creating jobs across all sectors for our young people. The attached Memorandum of Economic and Financial Policies (MEFP) describes the government's reform policies for the second half of 2012. We believe they will strengthen our macroeconomic management framework, sustain the robust external and fiscal positions, maintain stable monetary conditions, and bolster the financial sector. In order to ensure firm implementation, the program will continue to be monitored through quantitative performance criteria and indicative targets, structural benchmarks, and the final review in November in 2012. Looking forward, to preserve the reform momentum, we would be very interested in continuing a strong engagement with the Fund through a successor arrangement once the current SCF expires.

We intend to maintain a close policy dialogue with the Fund, and stand ready to take additional measures, as appropriate, to ensure the achievement of the government's macroeconomic objectives under the precautionary SCF. We will consult with the Fund in advance on adopting these measures, or on any revisions to the policies laid out in the MEFP, in accordance with the Fund's policy on such consultation. Furthermore, we will provide the Fund with any information it may request on policy implementation, as necessary, to achieve program objectives. We also authorize the publication of this Letter of Intent and the attached MEFP.

Sincerely yours,

/s/

Hon. Rick Houenipwela, MP
Minister of Finance and Treasury
Ministry of Finance and Treasury

/s/

Denton Rarawa
Governor
Central Bank of Solomon Islands

Attachments: Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding

ATTACHMENT I

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

1. **Macroeconomic conditions have improved.** The rigorous implementation of the IMF programs over the last two years, together with strong political will, has helped restore economic and financial stability and triggered donor support. After contracting by 5 percent in 2009, activity rebounded to 6¾ percent in 2010 and to more than 10 percent in 2011. External and fiscal buffers have been rebuilt. Gross international reserves reached almost US$ 450 million (about 10 months of this year's imports of goods and services) as of April 2012, compared with less than US$100 million in early 2009. However, growth remains concentrated in the commodity sector with limited spill-over to the rest of the economy.

2. **The near- and medium-term outlook remains favorable, but we face large risks.** If downside risks do not materialize, in the near term we expect growth to remain healthy at just over 6 percent in 2012, with gold production taking over logging as the main driver of growth. Over the medium term, we expect logging output to decline, but gold production, alongside transport, construction and services should continue to support growth in the 4 percent range. Headline inflation is likely to revert to about 5 percent over the medium term as commodity prices stabilize. The balance of payments position should also remain strong. The main downside risks include the impact on emerging Asia of an escalation of financial turmoil in Europe and a large increase in oil prices triggered by geopolitical risks which could take a large toll on economic growth. The main channels of contagion would be through a deterioration in the terms of trade, contraction in demand for logging from Asia—especially China, our main trading partner—and through financial linkages. However, the resilience of Australian banks should minimize a funding shock risk.

3. **The program under the SCF arrangement is on track**. The program targets for end-December 2011 were met with comfortable margin. We have also implemented two benchmarks committed under the program and have made substantial progress toward achieving the others.

I. PROGRAM POLICIES

4. **Our policies are aimed at enhancing resilience to shocks and implementing growth-oriented structural reforms.** These goals would help boost investor confidence and ensure sustainable and inclusive growth. To this end, our program will continue to focus on strengthening the fiscal management framework, improving monetary operations, maintaining a strong foreign exchange position, and containing financial risks. In order to strengthen ownership and build a strong consensus, we will continue to allow for wider consultations among stakeholders in implementing our ambitious structural reform plan.

A. Fiscal Policies

5. **We remain committed to preserving a strong fiscal position while providing adequate resources for critical social spending to ensure that growth is more inclusive.** The fiscal position strengthened considerably in 2011 as a result of buoyant revenues and better fiscal management. For this reason we request the modification of the end-June 2012 performance criteria. We realize that revenue will continue to remain volatile in the near term, however, owing to its reliance on commodities and that it will decline in the medium term as logging stocks are expected to be exhausted over the next decade. Thus, we will strike a balance between preserving strong fiscal buffers and refocusing on critical infrastructure and priority social spending such as on health and education, to lift long-term potential growth. To achieve these near- and medium-term goals, we will ensure that fiscal policy for the remainder of this year is consistent with the following policies:

- To retain an adequate fiscal buffer, we are strongly committed to preserving the cash balance in line with the 2012 budget. We transferred SI$80 million of savings in January 2012 from the cash balance to a contingency fund (SIG Consolidated Deposits Accounts) that is kept at the CBSI but is not part of the program cash balance. This contingency fund is maintained as an emergency buffer and its balance was SI$140 million in January. Our revised cash balance targets for 2012 reflect this account and are based on the assumption that the balance in the contingency fund would not be lower than SI$140 million. Where required and pending any further marked deterioration in the global economy, we will make necessary fiscal adjustments in order to meet our cash balance target. A prudent fiscal stance is also warranted in light of the recent intensification of inflation pressures. Should commodity revenue surprise on the upside, or under-spending of the development budget materialize due to capacity constraints, we will save this windfall for future development spending or increase fiscal space to buffer future shocks. To help anchor fiscal plans, we will move toward targeting the non-commodity fiscal balance as opposed to the cash balance in the medium term, as mining becomes a larger source of government revenue. This will insulate the budget from the volatility of commodity revenues, help smooth expenditure over the business cycle, and ensure a long-term sustainable use of exhaustible resources.

- To make meaningful progress toward our goal of achieving inclusive growth and alleviating poverty, we will continue to allocate more resources toward social sectors (health and education) and infrastructure as envisaged in the 2012 budget. We have established mechanisms to track government-funded spending on health and education. Accordingly, we are setting an indicative target for spending on these two sectors at no less than 32 percent of government-funded recurrent spending as part of our economic program with the IMF. This goal is in line with our economic reform agenda and consistent with our undertakings under the Core Economic Working Group. We will also make a larger contribution to the National Transport Fund (NTF) in 2012 to finance transportation infrastructure which will trigger positive growth spillovers and encourage private sector activity. The forthcoming Pacific Arts Festival has provided the opportunity to rebuild roads and invest in infrastructure in line with our national development strategy. To capture the activities of NTF and its impact on the overall fiscal stance, going forward we will report to the IMF monthly data on the accounts of the NTF, including its sources of funding such as transfers from the budget and external grants, expenditures by project, and changes in the NTF accounts at the CBSI and commercial banks.

- To strengthen public financial management and better monitor priority spending, we will continue to make progress toward improving our budget presentation. A considerable step has been achieved in February 2012 when we revised the budget presentation to include output line items, thus attaining a program benchmark (originally set for September 2012) ahead of schedule. We also improved the transparency of the budget process through extensive consultations with non-government organizations and ministries. We will also continue to seek assistance from development partners to strengthen procurement and internal audit processes to reduce leakages that affect public service delivery.
- To avoid waste and rationalize expenditure, we will contain growth of non-essential recurrent spending including by streamlining spending on public sector allowances and benefits.
- To enhance the efficiency of public service delivery and to attract and retain professional and technical personnel in the public service, it is important that the basic supporting mechanisms are improved. This includes resolving existing payroll and establishment problems. It is also key that the appropriate levels of remuneration and pay adjustments are addressed. It is a long process, but the government has made progress and will continue working toward these objectives.
- We will continue to boost domestic revenue by strengthening compliance and streamlining exemptions. A new comprehensive draft bill on customs and excise tax is being drafted (revised benchmark) with the assistance of Asian Development Bank and co-financed by the AusAID. We will submit to Cabinet the new bill by end-October 2012 (redrafted benchmark date) together with the required amendments to other revenue acts (income tax, stamp duties, goods and sales tax acts). This bill already incorporates strengthened exemption rules, which makes the draft amendments on exemptions, originally included as an IMF benchmark, redundant.
- Implementing a new resource taxation regime will be critical for the country to benefit from its natural resource wealth. In this context, we will seek by September 2012 Cabinet approval of draft amendments to income tax, custom and excise tax, and goods tax legislations to implement a new mining taxation regime, in line with IMF technical assistance recommendations (program benchmark). This reform is taking longer than expected to allow a wider consultation process with different stakeholders such as extractive companies, civil society, and landowners. A consultation meeting with all stakeholders will be held in June. Until this new tax regime is in place, we will refrain from approving new mining leases. At the same time, we will adopt measures to enhance

our revenue administration in the area of mining taxation to ensure that the Government receives its share of mining revenue.

- Strengthening the fiscal framework and public management by continuing to reform the Public Finance Act (PFA) is a high priority for this Government. We are aiming at submitting to Cabinet the draft Act by mid-November (redrafted benchmark date). The new PFA will incorporate provisions on fiscal responsibility, management and use of public funds, and management of public debt. The process involves the production of four discussion papers. Significant progress has been made so far since the review of the Act was announced last October: the release of a discussion paper in February, followed by public consultation; the release of the second and third discussion papers is expected for late May or early June.

- Exercising caution in resuming concessional borrowing would be key in preserving external stability while tapping resources to finance much needed investment projects. These could include the submarine internet cable project and the Tina River Power Project, which will reduce the cost of doing business and encourage private sector investment. The Debt Management Strategy (DMS) endorsed in May by the Cabinet, building on the results of the IMF-World Bank Debt Sustainability Analysis, provides the appropriate framework to anchor borrowing plans going forward. The DMS supersedes the Honiara Club Agreement (HCA) review (program benchmark). The review is being completed by presenting the DMS bilaterally to HCA signatories and observers.

B. Monetary, Exchange Rate, and Financial Sector Policies

6. **Monetary and exchange rate policies will continue to be geared to maintaining price and external stability.** Given the comfortable level of foreign reserves, the Central Bank of Solomon Islands (CBSI) allowed the currency to appreciate by 8.8 percent against the U.S. dollar in the second half of 2011 as a way to mitigate imported inflation. However, inflation pressures have reemerged lately driven by sustained domestic demand and high oil prices. As a result, monetary policy will need to be tightened by raising the reserve requirement and scaling up open-market operations, including through the issuance of *Bokolo* bills. While the current exchange rate regime has provided a strong nominal anchor, exchange rate policy will continue to be managed in a flexible manner to buffer against external shocks. To reinforce the effectiveness of the CBSI in conducting monetary policy and its supervisory activities, we have drafted a new CBSI Act. The process took longer than expected to allow us to conduct stakeholder consultations, and to incorporate the Attorney General's amendments. We will seek Cabinet approval of the draft act by June 10, 2012 (program benchmark).

7. **We will continue our efforts to strengthen the financial supervisory and regulatory frameworks, and improve access to credit.** To facilitate large project financing, prudential guidelines on the single borrower limits was revised by end-2011, taking into consideration the constraints posed by the small size of the banking system and the predominance of three foreign banks. The Financial Institutions Act of 1990 will also be

amended to reflect structural changes in the financial system and the latest international best practices. To this end we have requested IMF technical assistance that will be delivered later this year. To encourage financial access by small enterprises, we will explore options to enhance the use of the small business finance scheme administrated by the CBSI and Secured Transactions Act.

8. **Reforming the National Provident Fund (NPF) to improve its governance and investment framework would be key to provide retirement income and maintain financial stability**. We plan to seek Cabinet approval of the drafting instructions to the amendments to the NPF Act by end-June 2012 (program benchmark), in line with program commitments. This reform will strengthen the NPF's governance structure, reduce political influence on investment decision, and maximize returns to its members. We would like to request IMF technical assistance on strengthening on-site supervision of NPF, insurance companies, and pension funds.

I. Other Issues

9. **Safeguards assessment.** We agreed to ensure the completion of the Safeguards Assessment update by the time of the IMF Board meeting at the end of June. We understand from the IMF Finance Department that the schedule for finalizing this assessment is on track.

10. **Statistics and data monitoring provisions.** Progress has been made in strengthening the quality of national account statistics and fiscal and monetary data, but we will continue to improve the timely reporting of the program relevant data. We will also devote more resources to improving the collection and the quality of national accounts statistics; however, the quality of the national accounts is also dependent on input data from the wider national statistical system across the country. We would like to request IMF technical assistance on statistical sampling techniques, as related to conducting business and employment surveys. We will also continue to encourage our staff, including from the national statistics office, to apply to the IMF economic and financial programming courses, as part of the on-going efforts in capacity building.

Table 1. Solomon Islands: Quantitative Performance Criteria (PC) and Indicative Targets (IT)

	12/31/2011			3/31/2012			6/30/2012		9/30/2012	
	PC (CR/11/359)	PC with adjustors	Act.	IT (CR/11/359)	IT with adjustors	Est.	PC (CR/11/359)	Rev. PC	IT (CR/11/359)	Rev. IT
Performance criteria 1/										
Net international reserves (NIR) of the Central Bank of Solomon Islands (CBSI) (floor, end-of-period stock, in millions of U.S. dollars (US$)) 2/	345	341	396	351	347	424	357	421	364	428
Net domestic asset (NDA) of the CBSI (ceiling, end-of-period stock, in millions of Solomon Islands dollars (SI$)) 3/	-767	-737	-1,118	-870	-836	-1,331	-869	-1,253	-875	-1,256
Net credit to central government (NCG) (ceiling, cumulative change from the beginning of the year, in millions of SI$) 4/	-58	-27	-561	27	61	-143	19	-28	4	-26
New nonconcessional external debt maturing in more than one year, contracted or guaranteed by the public sector (ceiling, end-of-period stock since the beginning of the program, in millions of US$) 5/	0	0	0	0	0	0	0	0	0	0
New nonconcessional external debt maturing in one year or less, contracted or guaranteed by the public sector (ceiling, end-of-period stock since the beginning of the program, in millions of US$) 5/	0	0	0	0	0	0	0	0	0	0
Accumulation of new external payment arrears by the public sector (ceiling, end-of-period stock since the beginning of the program, in millions of SI$) 5/	0	0	0	0	0	0	0	0	0	0
Central government program cash balance (floor, end-of-period stock, in million of SI$) 4/	287	254	522	287	233	402	292	342	313	392
Indicative Targets (cumulative)										
Government funded recurrent spending on health and education	…	…	…	…	…	…	…	273	…	409
Memorandum items:										
Budget support from bilateral and multilateral donors other than IMF (cumulative change from the beginning of the year, in millions of US$), program level.	50	…	46	14	…	9	30	38	44	47
Outstanding stock of Solomon Islands government (SIG) treasury bills, excluding restructured government bonds (end-of-period stock, in millions of SI$), program level.	40	…	38	60	…	40	60	60	60	60
Balance of SIG Consolidated Deposits Account, millions of SI$.6/	…	…	60	…	…	140	…	140	…	140

1/ Evaluated at the program exchange rate.

2/ The adjustors are specified in the Technical Memorandum of Understanding (TMU) and include: the floor on NIR will be adjusted upward (downward) by the amount of budget support from bilateral and multilateral donors (excluding IMF) in excess (short) of the program level.

3/ The adjustors are specified in the TMU and include: the ceilings on NDA will be adjusted downward (upward) by the amount of budget support from bilateral and multilateral donors (excluding the IMF) in excess (short) of the program level. Following the recommendations of the IMF Safeguards Assessment, the program targets starting from end-December 2010 incorporate the recommended changes in the measurement of reserve money. Such changes, however, are not applied in measuring the September 2010 NDA outcome to make it consistent with the September 2010 IT, which was set before the changes were made.

4/ The adjustors are specified in the TMU and include: the floor on central government program cash balance will be adjusted downward and the ceiling on NCG will be adjusted upward by the stock amount of budget support from bilateral and multilateral donors (excluding the IMF) short of the program level; the floor on the program cash balance will be adjusted upward (downward) by the stock of government treasury bills, excluding restructured government bonds, in excess (short) of the program level; the floor on the program cash balance will be adjusted upward by the balance in the SIG Consolidated Deposits Account short of the program level (this adjustor applies to end-June PC and end-September IT).

5/ These performance criteria are applicable on a continuous basis.

6/ The SIG Consolidated Deposits Account functions like a contingency fund for the government and transfers to and from this account can affect the program cash balance. Negative deviations from the projected balance in this account will therefore be used to adjust the program cash balance targets upward. The balance in this account for end-2011 and end-March 2012 are reported for reference since the balance in this account has not been monitored previously as part of the program.

Table 2. Solomon Islands: Structural Benchmarks

Actions	Macroeconomic criticality	Date	Status
Submit to Parliament the amendment to the Customs and Excise and Income Tax Acts to strengthen exemption rules and clarify the role of exemption committee	To promote fiscal transparency and enhance the efficiency of revenue collections.	December 31, 2011	Not met, but superseded by a more comprehensive reform. A new comprehensive draft bill on customs and excise tax, including reforming exemption rules, is being drafted with the assistance of the ADB co-financed by Ausaid, as opposed to amending ad hoc the previous draft. Parliament is not likely to reconvene before December. This benchmark has been replaced by a new benchmark (see below).
Obtain Cabinet approval of a draft amendment to income tax, customs and excise tax, and goods tax legislations related to the new mining tax regime in line with IMF TA recommendations.	To broaden the tax base and increase revenue transparency.	March 31, 2012	Not met, but in progress. This reform is taking longer than expected to allow a wider consultation process with different stakeholders such as extractive companies, civil society, and landowners. Documentation has been already circulated to stakeholders as part of the public consultation process, including a summary of the amendments and draft legislations (see below, re-set date).
Obtain Cabinet approval of draft amendment to the CBSI Act to strengthen the monetary policy and supervisory framework.	To strengthen the effectiveness of monetary policy.	March 31, 2012	Not met, but expected to be met with delay by June 10, 2012. Public consultation was held on April 23. Work on the reform of the CBSI Act is now complete and the authorities expect to submit the final draft to Cabinet for endorsement by June 10.
Complete the Honiara Club Agreement (HCA) review and reach agreements on amendments to the HCA.	To strengthen debt management and maintain public debt sustainability.	April 30, 2012	Met. The Debt Management Strategy (DMS), endorsed by Cabinet on May 10, supersedes the Honiara Club Agreement (HCA) review. The review is being completed by presenting the DMS bilaterally to HCA signatories and observers.
Obtain Cabinet approval of the drafting instructions to revise the NPF Act incorporating the reform plan approved by the Cabinet to strengthen its governance structure and investment framework.	To improve the long-term financial viability of the NPF and reduce fiscal risks.	June 30, 2012	On track. The TA from Australian Treasury has been secured and is currently assisting to progress the review of the NPF Act. The drafting instruction is expected to get cabinet approval by June 2012.
Revise the budget presentation from input line items to functional/output line items.	To strengthen the quality and monitoring of government spending.	September 30, 2012	Met. The revised presentation has been provided in the 2012 Budget paper approved in February 2012.
Obtain Cabinet approval of the draft of new Public Finance and Audit Act that covers fiscal responsibility provisions, management and use of public funds, and management of public debt.	To strengthen budget management and ensure fiscal sustainability.	September 30, 2012	In progress. It has been replaced by a new benchmark and a new intermediate benchmark has been also introduced (see below). The process involves the production of four discussion papers, one of which has been completed. The remaining three will be completed by end-June. Public consultations will be required (in September) before the final draft bill is submitted to Cabinet for approval.
Revised and New Benchmarks			
Obtain Cabinet approval of a draft amendment to income tax, customs and excise tax, and goods tax legislations related to the new mining tax regime in line with IMF TA recommendations.	To broaden the tax base and increase revenue transparency.	September 30, 2012	
Discussion papers and draft legislation of the new Public Finance Act to be presented at a public workshop.	To strengthen budget management and ensure fiscal sustainability.	September 30, 2012	
Submit to Cabinet the new Customs and Excise bill, including the clauses related to exemptions and the draft amendments to other revenue acts (income tax, stamp duties, goods and sales tax acts).	To promote fiscal transparency and enhance the efficiency of revenue collections.	October 31, 2012	
Submit to Cabinet the draft of new Public Finance Act that covers fiscal responsibility provisions, management and use of public funds, and management of public debt.	To strengthen budget management and ensure fiscal sustainability.	November 15, 2012	

ATTACHMENT II

SOLOMON ISLANDS: TECHNICAL MEMORANDUM OF UNDERSTANDING

1. The program will be monitored through quantitative performance criteria, indicative targets, structural benchmarks, and reviews. This memorandum sets out the definitions for quantitative performance criteria and indicative targets under which performance under the program will be assessed. Monitoring procedures and reporting requirements are also specified.

I. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS

2. Performance criteria for end-December 2011 and end-June 2012 and indicative targets for end-March 2012 have been established with respect to:

- Floors on the level of net international reserves (NIR) of the Central Bank of Solomon Islands (CBSI);
- Ceilings on the level of net domestic assets (NDA) of the CBSI;
- Ceilings on the level of net credit to the central government (NCG); and
- Floors on the central government cash balance.

3. Performance criteria applicable on a continuous basis have been established with respect to:

- Ceilings on the contracting and guaranteeing by the public sector of new medium- and long-term nonconcessional external debt;
- Ceilings on the contracting and guaranteeing by the public sector of new short-term nonconcessional external debt; and
- Ceilings on accumulation of new external payment arrears by the public sector.

II. INSTITUTIONAL DEFINITIONS

4. The central government includes all units of budgetary central government and extra budgetary funds.

5. Depository corporations (DCs) include the CBSI and other depository corporations (ODCs). ODCs include commercial banks, the Credit Corporation of Solomon Islands, and credit unions. Financial corporations include DCs and other financial corporations (OFCs). OFCs are the National Provident Fund (NPF), the Development Bank of Solomon Islands, and the Investment Corporation of Solomon Islands.

III. MONETARY AGGREGATES

6. **Valuation.** Foreign currency-denominated accounts will be valued in Solomon Islands dollar (SI$) at the program exchange rate of SI$7.42 per U.S. dollar, as of end-June 2011. Foreign currency accounts denominated in currencies other than the U.S. dollar and

monetary gold will first be valued in U.S. dollars at actual exchange rates and gold prices used by the CBSI, respectively, before they are converted to Solomon Islands dollars.

A. Reserve Money

7. Reserve money consists of currency issued by the CBSI (excluding CBSI holdings of currency) and all transferable deposits held at the CBSI.

B. Net International Reserves of the CBSI

8. A floor applies to the level of NIR of the CBSI. The floor on NIR will be adjusted upward (downward) by the amount of budget support from bilateral and multilateral donors (excluding IMF) in excess (short) of the programmed level.

9. NIR will be calculated as gross international reserves (GIR) less international reserve liabilities. For program monitoring purposes, the stock of foreign assets and foreign liabilities of the CBSI, as reported in Solomon Islands dollars, shall be valued at program exchange rate in U.S. dollars, as described on paragraph 6.

10. GIR of the CBSI are defined as the sum of:

- Foreign currency assets in convertible currencies held abroad and as vault cash that are under the direct and effective control of the CBSI and readily available for intervention in the foreign exchange market or the direct financing of balance of payments imbalances and are of investment grade or held with an investment-grade institution.
- The reserve position of the Solomon Islands in the IMF;
- Holding of SDRs; and
- Monetary gold.

Excluded from the definition of GIR are:

- Foreign currency deposits of ODCs and OFCs held at the CBSI;
- Any foreign currency claims on residents, capital subscriptions in international institutions, and foreign currency assets in nonconvertible currencies, and;
- GIR that are in any way encumbered or pledged, including, but not limited to, reserve assets used as collateral or guarantee for third-party external liabilities.

11. International reserve liabilities of the CBSI are defined as the sum of:

- All outstanding liabilities of the Solomon Islands to the IMF, excluding IMF SDR allocations; and
- Foreign currency liabilities in convertible currencies to nonresidents with an original maturity of up to and including one year.

C. Net Domestic Assets of the CBSI

12. A ceiling applies to the level of NDA of the CBSI. The ceiling on NDA will be adjusted downward (upward) by the amount of budget support from bilateral and multilateral donors (excluding IMF) in excess (short) of the programmed level.

13. NDA of the CBSI will be calculated as the difference between reserve money and the sum of NIR of the CBSI and other NFA of the CBSI. Any revisions to the historical stock of reserve money based on changes to the accounting treatment of the profit/loss account of the CBSI will be notified to the Fund immediately and used to adjust monetary aggregates by an equivalent amount, as deemed appropriate. Other NFA of the CBSI includes:

- Foreign assets related to holdings of foreign currency deposits, and securities not included in NIR of the CBSI, and loans, shares, financial derivatives, or accounts receivable with nonresidents; and other foreign assets that are not included in NIR of the CBSI, as defined in Section III. B; and

- Foreign liabilities related to IMF SDR allocations; deposits, securities, loans, financial derivatives, and other accounts payable with nonresidents; and other foreign liabilities that are not included in NIR of the CBSI, as defined in Section III. B.

D. Net Credit to the Central Government

14. A ceiling applies to the NCG measured cumulatively from the beginning of the year. The ceiling on NCG will be adjusted upward by the amount of budget support from bilateral and multilateral donors (excluding IMF) short of the programmed level.

15. NCG is defined as the sum of net claims of: (i) the CBSI, (ii) commercial banks and other ODCs, (iii) OFCs, (iv) insurance companies, (v) and government treasury bills held by the general public.

IV. FISCAL AGGREGATES

A. Cash Balance of the Central Government

16. A floor applies to the program cash balance of the central government. The floor on the program cash balance will be adjusted downward by the amount of budget support from bilateral and multilateral donors (excluding IMF) in short of the programmed level. The floor on the program cash balance will also be adjusted upward (downward) by the stock of government treasury bills, excluding restructured government bonds, in excess (short) of the program level of SI$40 million in 2011 and SI$60 million in 2012. Starting with the end-June 2012 target, the floor on the program cash balance will be adjusted upward by the difference between the January 2012 level of SI$140 million in the SIG Consolidated Deposits Account and its actual balance, should the actual balance in the SIG Consolidated Deposits Account be lower than SI$140 million.

17. The program cash balance of the central government is defined as the gross cash balance minus the total amount of unpaid payment orders and unpresented checks.

18. The gross cash balance is defined as the sum of government deposits, which are not in any way encumbered or pledged as collateral or used as a guarantee against government incurred liabilities, in the following accounts:

- In CBSI: Solomon Islands Government (SIG) Revenue Account, SIG Funded Development Account, SIG Debt Servicing Account;
- In Australia New Zealand Bank: SIG Creditors Account; Payroll Imprest Account, and Airport Service Fees Account;
- In Bank of South Pacific: Provincial Revenue Holding Account, SIG Inland Revenue Account, Sub Treasury Gizo Account, and Sub Treasury Auki Account; and
- Donor funded budget support accounts that are created by and under control of the government.

V. External Debt

A. Medium- and Long-Term External Debt

19. A ceiling applies to the contracting and guaranteeing by the public sector of new nonconcessional borrowing with nonresidents with original maturities of more than one year. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. This applies to private debt for which official guarantees have been extended and which, therefore, constitutes a contingent liability of the public sector. The public sector comprises the central government, the CBSI, nonfinancial public enterprises (i.e., enterprises in which the government owns more than 50 percent of the shares), and other official entities.

20. The definition of debt, for the purposes of the program, is set out in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangement Executive Board Decision No. 6230-(79/140), as revised on August 31, 2009 (see Annex I).

21. Excluded from the ceiling are (i) the use of Fund resources; (ii) lending from the World Bank and the Asian Development Bank; (iii) debts incurred to restructure, refinance, or prepay existing debts, to the extent that such debt is incurred on more favorable terms than the existing debt and up to the amount of the actually restructured/refinanced/prepaid debt; (iv) concessional debts; (v) any SI$-denominated treasury bill and bond holdings and Bokolo bonds held by nonresidents.

22. For program purposes, the guarantee of a debt arises from any explicit legal obligation of the central government, the CBSI, nonfinancial public enterprises, or other official entities on behalf of the central government or the CBSI to service debt in the event of nonpayment by the main obligor (involving payments in cash or in kind).

23. For program purposes, a debt is concessional if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the net present value (NPV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The NPV of debt at the time of its contracting is calculated by

discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the currency specific commercial interest reference rates (CIRRs), published by the Organization for Economic Cooperation Development (OECD). For debt with a maturity of at least 15 years, the 10-year-average CIRR will be used to calculate the NPV of debt and, hence, its grant element. For debt with a maturity of less than 15 years, the 6-month average CIRR will be used. To both the 10-year and 6-month averages, the same margins for differing repayment periods as those used by the OECD would continue to be added (0.75 percent for repayment periods of less than 15 years, 1 percent for 15 to 19 years, 1.15 percent for 20 to 29 years, and 1.25 percent for 30 years or more).

B. Short-Term External Debt

24. A ceiling applies to the contracting and guaranteeing by the public sector of new nonconcessional borrowing with nonresidents with original maturities of up to and including one year. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. This applies to private debt for which official guarantees have been extended and which, therefore, constitute a contingent liability of the public sector.

25. For program purposes, the definition of debt is set out in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangement approved by the Executive Board Decision No. 6230-(79/140), as revised on August 31, 2009 (see Annex I).

26. Excluded from the ceiling are (i) debts classified as international reserve liabilities of the CBSI; (ii) debts incurred to restructure, refinance, or prepay existing debts, to the extent that such debt is incurred on more favorable terms than the existing debt and up to the amount of the actually restructured/refinanced/prepaid debt; (iii) SI$-denominated treasury bills and bonds and CBSI and Bokolo bills held by nonresidents; and (iv) normal import financing. A financing arrangement for imports is considered to be "normal" when the credit is self-liquidating.

VI. External Payment Arrears

27. A continuous performance criterion applies to the nonaccumulation of external payments arrears by the public sector, comprising the central government, the CBSI, nonfinancial public enterprises, and other official entities. External payments arrears consist of external debt-service obligations (principal and interest) that have not been paid at the time they are due, as specified in the contractual agreements.

VII. Data Provision

28. The data listed below will be provided for monitoring performance under the program based on data templates agreed with Fund staff. Under each section, reporting responsibilities are indicated in parentheses. Weekly data are requested for submission to Fund staff by the end of the following week. Monthly and quarterly data are requested for submission within six weeks of the end of the observation period. The authorities have committed to using the best available data, so that any subsequent data revisions will not lead to a breach of quantitative performance criteria or benchmarks. All revisions to data will be promptly reported to Fund staff.

A. Monetary Data (CBSI)

On a weekly basis:

- Daily exchange rates, both buying and selling rates, of the Solomon Islands dollar against the U.S. dollar, including the official, interbank, and parallel market exchange rates;
- Stock of NIR and sales and purchases by the CBSI in the foreign exchange markets;
- Stock of reserve money and its components; and
- Treasury bill auction reports.

On a monthly basis:

- Financial corporations' survey, including the balance sheet of CBSI, the consolidated balance sheet of ODCs, and the consolidated balance sheet of OFCs;
- Liquid asset ratios and/or reserves requirement of the commercial banks;
- Interest rates, including average interbank rate, bank deposit rates, and bank lending rates;
- A detailed breakdown of NCG from the CBSI, commercial banks and other ODCs, and OFCs;
- Foreign exchange cash-flow of the CBSI, including donor disbursements; and
- Balances of each central government account specified in Section IV. A., as recorded or collected by the CBSI.

B. Fiscal Data (Ministry of Finance and Treasury (MoFT))

On a monthly basis:

- Consolidated accounts of the central government, including detailed data on:
    - Revenue, including tax and nontax revenues, and recurrent and development grants included in the consolidated budget;
    - Recurrent expenditure, including payroll, goods and services, and other recurrent outlays, including those funded by donor support;
    - Other recurrent charges of the Ministry of Education and Ministry of Health, separating spending funded by donor support;
    - Debt service payments, classified into amortization and interest payments on (i) domestic debt, (i) external debt, (iii) domestic arrears, and (iv) external arrears; and

  - Development expenditure funded by (i) central government of the Solomon Islands, and (ii) foreign grants and loans included in the consolidated budget.

- Detailed financing components of central government's accounts, classified into foreign and domestic sources.

  - Foreign financing includes (i) disbursement and amortization of project and program loans, and (ii) changes in external debt arrears, classified into principal and interest arrears.

  - Domestic financing includes (i) borrowing from and repayment to the CBSI, commercial banks and other ODCs, and OFCs; (ii) changes in deposits at the CBSI, commercial banks and other ODCs, and OFCs; and (iii) privatization receipts and changes in domestic debt arrears, classified into principal and interest arrears.

- Stock of domestic debt, including the outstanding balance of government securities, treasury bills, cash advances, and other debt instruments.

- Balances of each central government account specified in Section IV. A., as recorded by the MoFT.

- Stock of unpaid government payment orders and unpresented checks.

C. External Sector Data (CBSI and MoFT)

On a quarterly basis:

- New external debt obligations contracted and/or guaranteed by the government of the Solomon Islands, CBSI, and other official entities, including details on the amounts, terms, and conditions of each obligation.

- Stock of outstanding external debt at end-month and disbursement, amortization, and interest payments for short-term external obligations contracted or guaranteed by the government or the CBSI by creditor in original currency and U.S. dollars.

- Stock of external debt at end-month and disbursement, amortization, and interest payments for medium- and long-term external obligations contracted or guaranteed by the government or the CBSI by creditor in original currency and U.S. dollars.

- Stock of arrears on the external debt contracted or guaranteed by the government or the CBSI by creditor in original currency and in U.S. dollars at end-month.

On a quarterly basis:

- Balance of payment data, including detailed components of current accounts and capital and financial accounts.

D. Real Sector Data (MoFT, National Statistical Office)

On a monthly basis:

- The monthly consumer price index and a detailed breakdown by major categories of goods and services included in the consumer basket.

ANNEX I. GUIDELINES ON PERFORMANCE CRITERIA WITH RESPECT TO FOREIGN DEBT

Excerpt from Executive Board Decision No. 6230-(79/140), as revised on August 31, 2009

9. (a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and

(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

(b) Under the definition of debt set out in point 9 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.