

## Denton Rarawa: The current state of the Solomon Islands' economy and thoughts on the future

Paper presented by Mr Denton Rarawa, Governor of the Central Bank of Solomon Islands, to the University South Pacific Development Dialogue in Solomon Islands, Honiara, 17 September 2009.

\* \* \*

Distinguished USP Personnel  
Invited Guests  
Ladies and Gentlemen  
Good morning to you all

### Introduction

First let me thank the USP Faculty of Business & Economics for inviting the Central Bank to participate in this important gathering this morning. It is a privilege to be part of this Dialogue.

This morning I hope to provide a brief update of the current economic situation in Solomon Islands and to share with you a few thoughts on the direction in which I think we are heading as well as some challenges that need serious consideration by policy and decision makers. Some of these policy challenges are potential areas that institutions like USP can assist the country in by employing its academic research expertise. I believe this is one key goal of the Development Dialogue this morning.

I will begin by looking at the current condition of the productive sectors of the economy including some of the future challenges and opportunities these sectors are facing. Then I will move to areas for which the Central Bank is directly responsible; the monetary and financial sectors of the economy. I will also describe the actions that the Bank has taken to influence events and discuss policies we may implement in the future. I will conclude with some thoughts and advice for the future.

### Global economic crisis

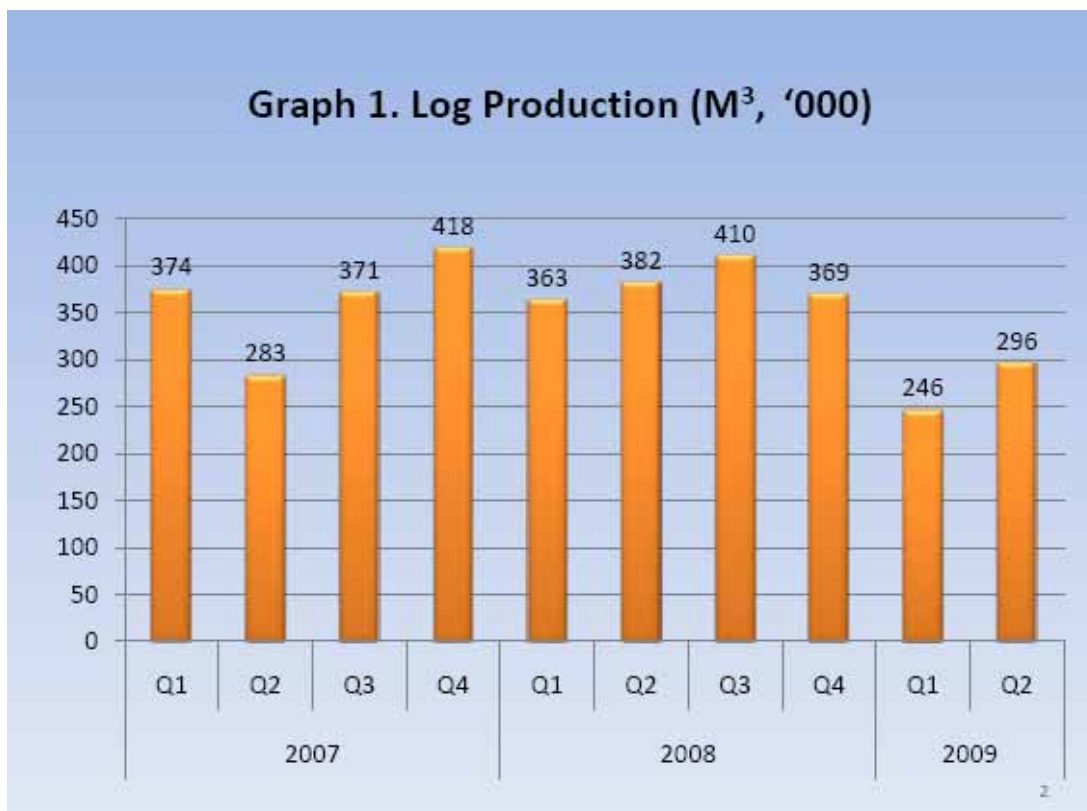
You are all aware that in the last eighteen months the global economy went through a severe financial and economic crisis that spared no country. Earlier this year when launching the Central Banks' 2008 annual report, I described the Solomon Islands economy then as a small boat in the middle of a severe storm. At that time, no one knew how strong the storm would be or how long it would last. But one thing was certain: the country has to survive the storm otherwise our boat ***MV Solomon Islands*** will sink.

Today there is growing evidence that the storm is abating. Signs of recovery are emerging around the world. Just yesterday, the Chairman of the Federal Reserve Ben Bernanke claimed that "the recession in the United States was over". Despite these positive signs however, Dominique Strauss-Kahn (the Managing Director of the International Monetary Fund) issued a stark warning only last week "that the global economic crisis isn't over yet". Other prominent commentators have suggested that growth will be "slow and uneven" and "unemployment will remain a problem".

### Real sector

The largest impact that the global economic crisis has had on Solomon Islands has been the reduction in our **log exports**. 2008 saw record levels of production from the forestry sector

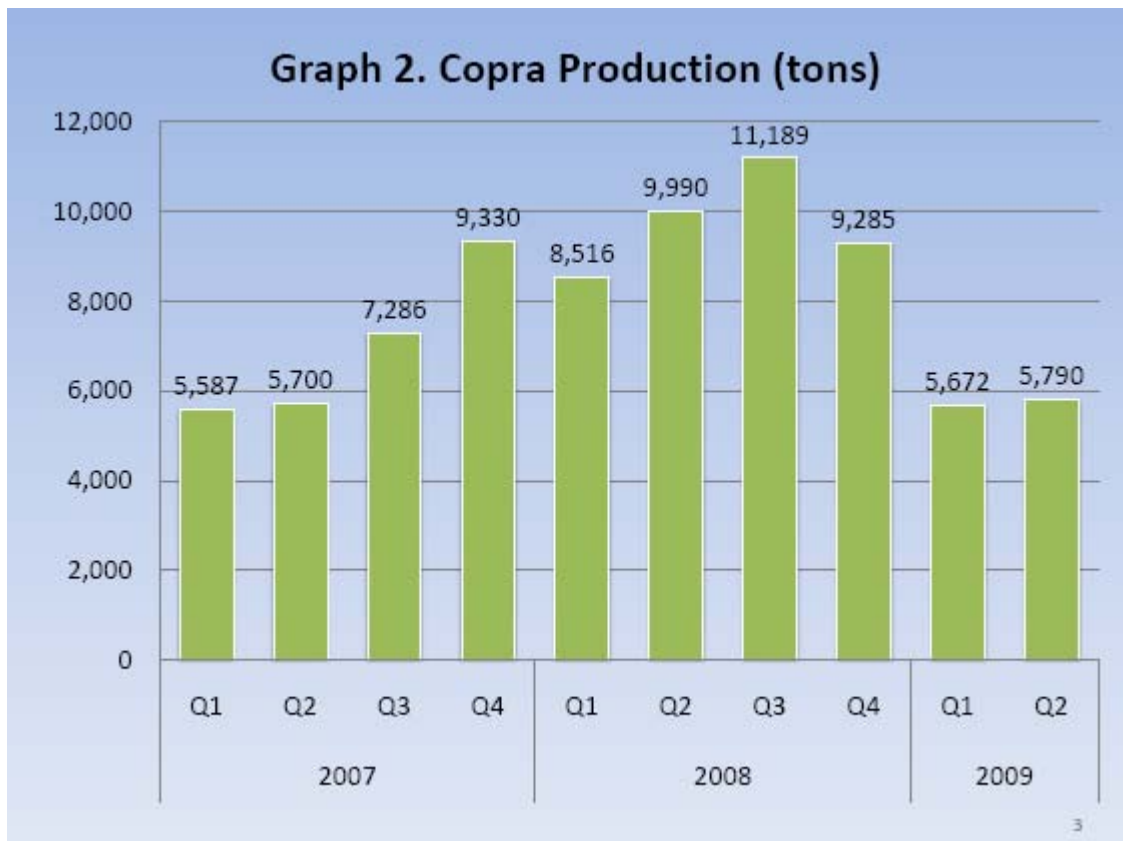
with 1.5 million cubic meters of timber being exported. This accounted for around 16% of GDP.



The global economic crisis led to reduced demand for raw materials particularly in Asia. The slowdown in China, the destination for around half of Solomon Islands' logs resulted in a decline in our timber industry. For Solomon Islands, logging has not only been a major contributor to growth but has also been our major export earner, an important source of employment and a crucial contributor to government revenues. The decline in logging that the crisis provoked has hurt the country.

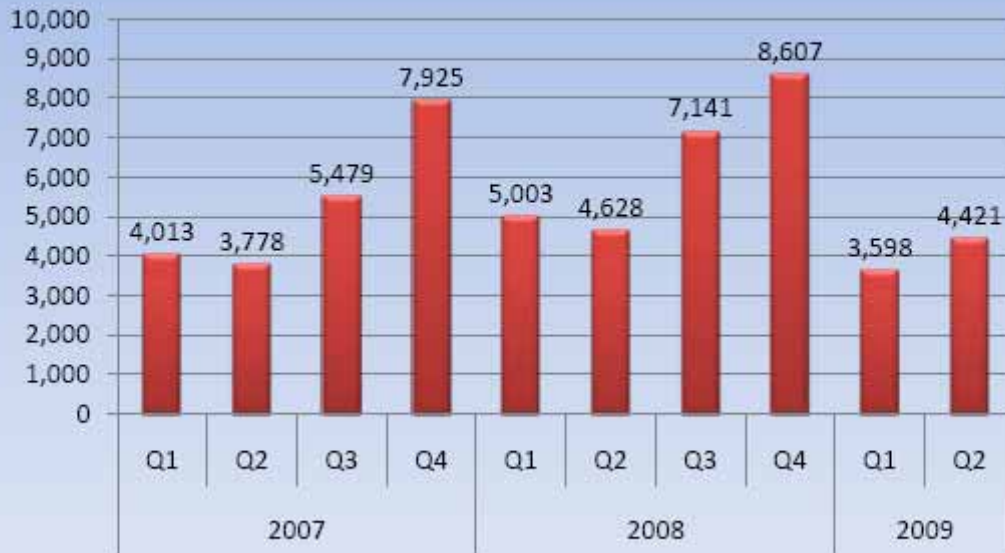
As the global economic situation recovers so we see a clear upturn in log exports. Second quarter results are up and the Bank predicts further increases in the third quarter. It must be remembered however, that the contribution of forestry to the Solomon Islands economy are numbered. We are destined to see a terminal decline in the industry due to the unsustainable rate of harvesting that has occurred. It is predicted that non-plantation logging will be fully exhausted in 4-5 years. In spite of any action we can take, the country will experience severe economic challenges as this industry declines unless new sources of growth can be found to take its place and take its place quickly.

Another industry that has declined in the first half of 2009 is **copra**. Copra is an important industry in Solomon Islands because it is the major cash crop in many rural areas. Strong world prices in 2008 generated record production in Solomon Islands. Since the third quarter of 2008 however, world prices for copra have sharply declined resulting in substantial falls in production. Second quarter output was 45% lower than that recorded in the same period last year. The flooding that Solomon Islands experienced in the first half of the year has further affected copra production. One major constraint on the growth of the copra industry in Solomon Islands has been infrastructure weaknesses. Problems in shipping and storage mean that even during the peak last year copra export levels have remained well below potential.



The **fishing industry** has also seen a subdued start to the year. This probably has more to do with domestic factors than with the global economic crisis. The first half of the year has seen one company cease fishing activities as part of its strategy to restructure and focus on processing. Poor fishing conditions have compounded this problem and magnified the decline in catch. It is anticipated that catch will rebound in coming months as two new fishing boats come into operation. Fisheries is a sector in which the Bank expects future growth with investment into the sector remaining strong.

### Graph 3. Fish Catch (tons)



4

### Graph 4. Cocoa Production (Tons)

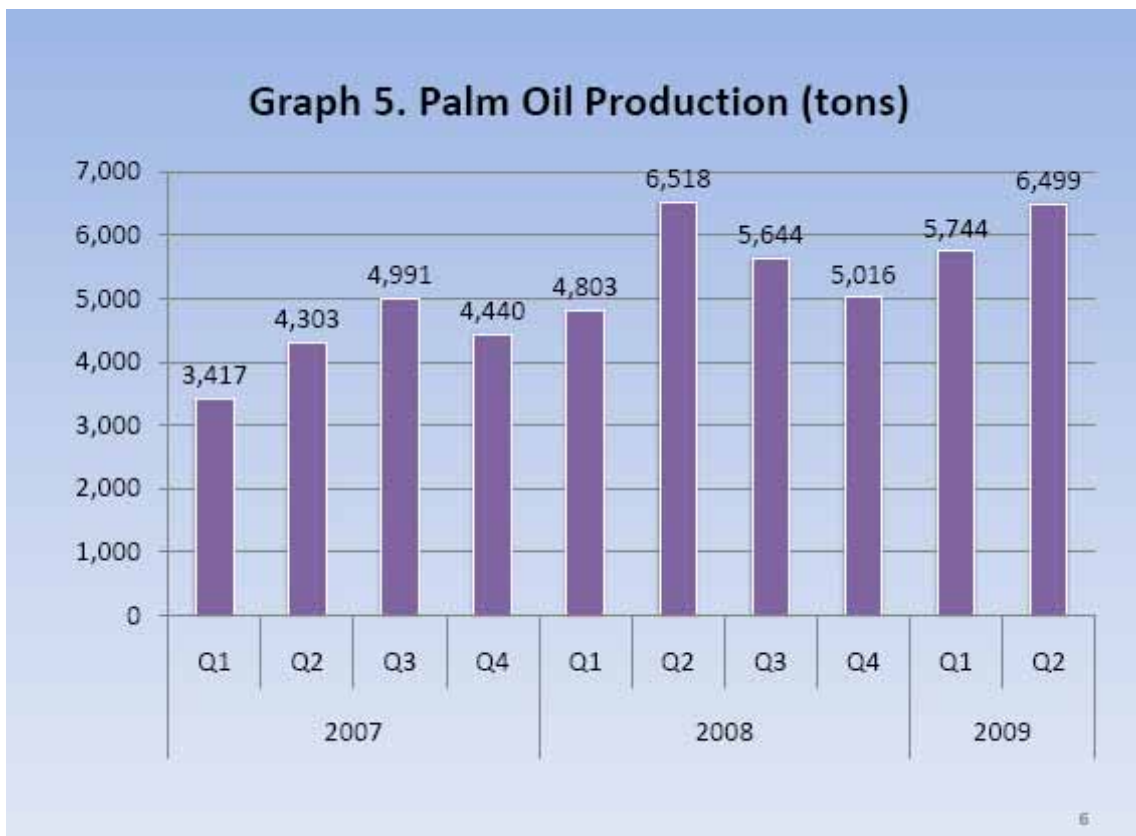


5

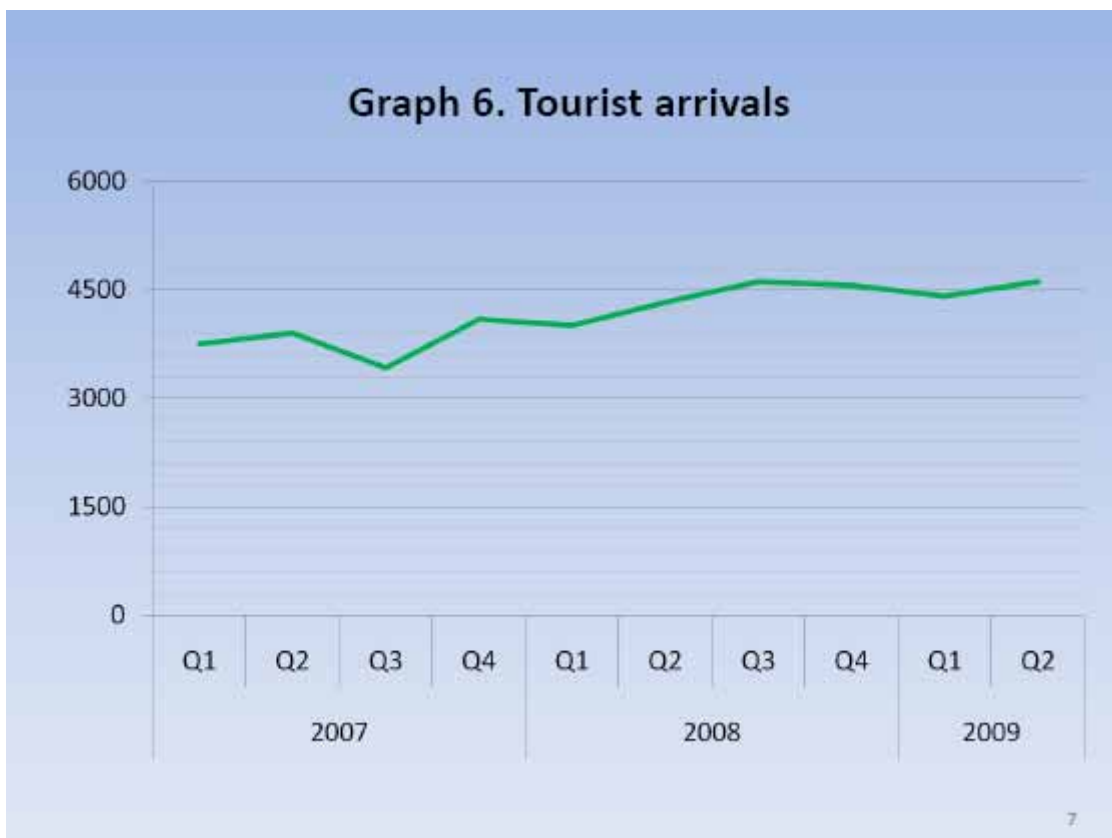
**Cocoa** production has been one success story in 2009. Due mainly to adverse weather conditions, cocoa production in 2008 was poor. Earnings in the industry were however sustained due to resilient international prices. Production levels for the second quarter have

been very promising. It is hoped that a combination of good harvests and a fair international price will enable the cocoa industry to contribute more to the Solomon Islands' economy in 2009. Cocoa forms an important source of income in many rural areas.

The continued growth of the **palm oil** industry in the country has also been a major positive in the last few years. 2008 saw a 28% increase in output in palm oil and further gains have already been witnessed in 2009. Expansion in the size and yield of plantations, increases in mill processing and improvements in worker productivity are combining to drive forward the palm oil sector. It is anticipated that falls in the price of palm oil experienced over the last few quarters will be only temporary as international demand for palm oil and palm oil products remains strong. This dip in prices also does not seem to have dampened the industries plans for expansion. Issues of security and land tenure however, remain as serious and continued risks to development of the industry. These issues must be confronted if this sector is to grow and increase revenues and employment in Solomon Islands.



**Tourism** has been identified by the Government as a key potential growth area. This sector has seen a 16% year-on-year growth in the second quarter of 2009. This is a very positive sign for the economy. One major contributor to this growth has been the recent entry of a low cost carrier to the Brisbane/Honiara route. This has increased competition and dramatically lowered fares for travelers. The upgrading of hotel facilities around Honiara and the opening of a new hotel on Honiara's waterfront may also boost tourism in the county. Limited infrastructure and problems with domestic air and sea travel, remains the major barrier to developing the tourism industry across the country.

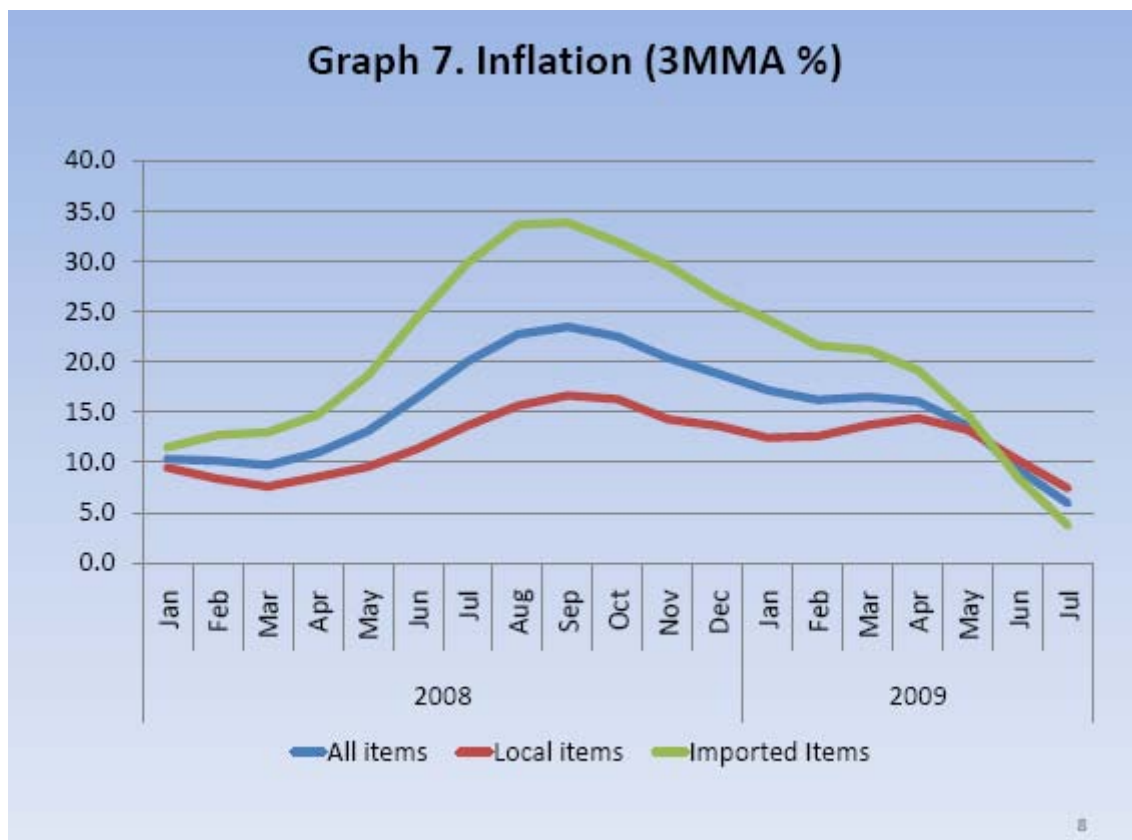


The Government has made steady progress in opening up the **telecommunications sector**. This is expected to provide a boost to the economy. The granting of a second mobile license could see new investment into the Solomon Islands economy. The experience of many countries is that the entrepreneurial use of mobile technology can reap huge rewards particularly in rural areas.

The last sector I will mention is **mining**. There are currently twelve mineral exploration companies active in Solomon Islands. The sector, although currently small, is becoming increasingly active. The main short term potential for the economy lies in gold production. According to industry predictions, a major gold mining project could be in operation on Guadalcanal by March 2010. In the longer term nickel may prove an important export for Solomon Islands. The country possesses major proven nickel reserves. The majority of mining projects however remain a long way from production and continued peace, stability and patience is vital to maintain investor's confidence in such projects.

### **Monetary and financial developments**

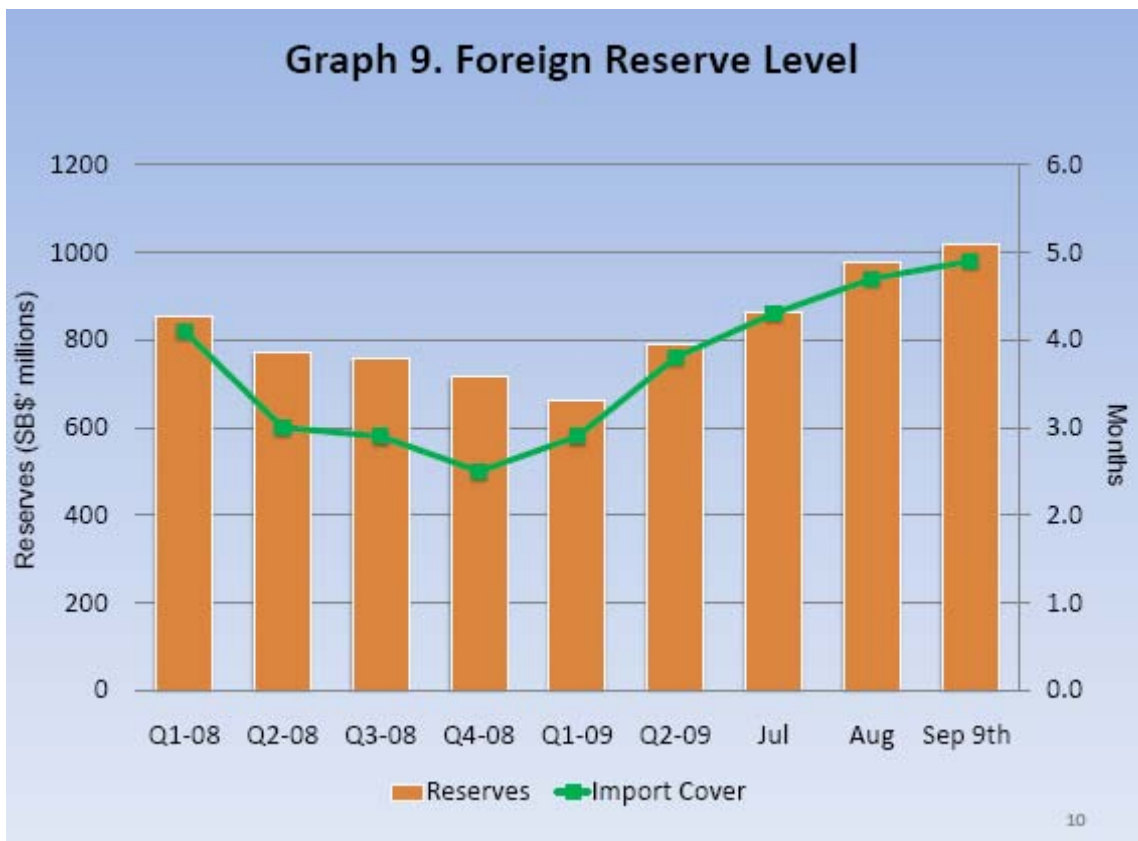
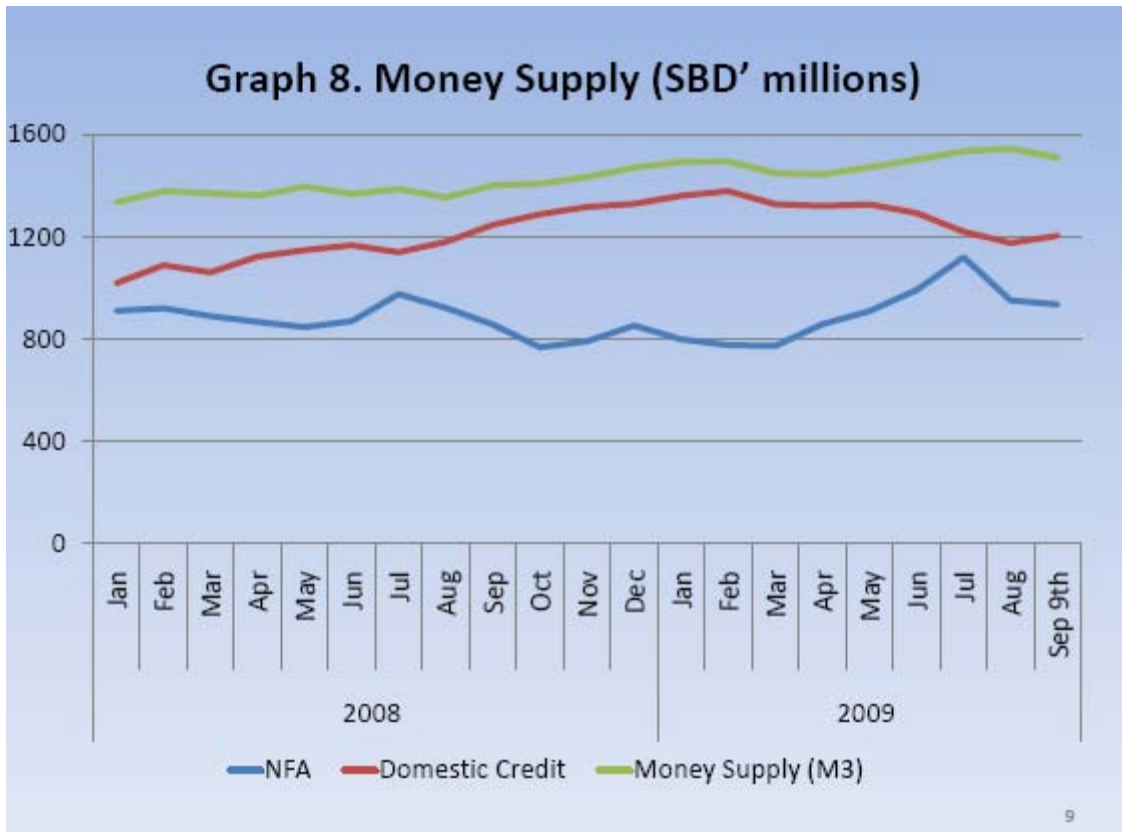
Let me turn to recent monetary and financial developments. It must be remembered that the impact of the global economic crisis on Solomon Islands has not been all bad. Whilst falling international commodity prices have had a damaging affect on our export receipts they have reduced the cost of imports. This has been a major contributing factor in the easing of inflation pressures. Falling world prices for oil and food in particular have been instrumental in reducing the inflation rate from 23.5% in September 2008 to 5.9% in July 2009.



The **lowering of inflation**, to a more sustainable level, **is a major policy goal** for the Central Bank, as set out in its 2009 monetary policy stance. Whilst international price falls have been one major contributor to this reduction in inflation, Central Bank intervention has also been important in increasing price stability. The CBSI intervened to reduce the level of excess liquidity in the financial system and so slow down lending, which was fueling inflation. In order to do this the Bank redefined the liquid asset ratio, which acted as a *de facto* raise in the required level of reserve holdings by the commercial banks. We also issued central bank backed securities and instituted a long run deposit facility to absorb liquidity from the system.

The Bank anticipates the level of inflation to remain well within target during the remainder of the year. We will however continue to remain vigilant. An unanticipated upsurge in fuel or rice prices could increase upward pressure on the inflation rate. Other potential threats to price stability include public sector wage inflation and potential fiscal dominance.

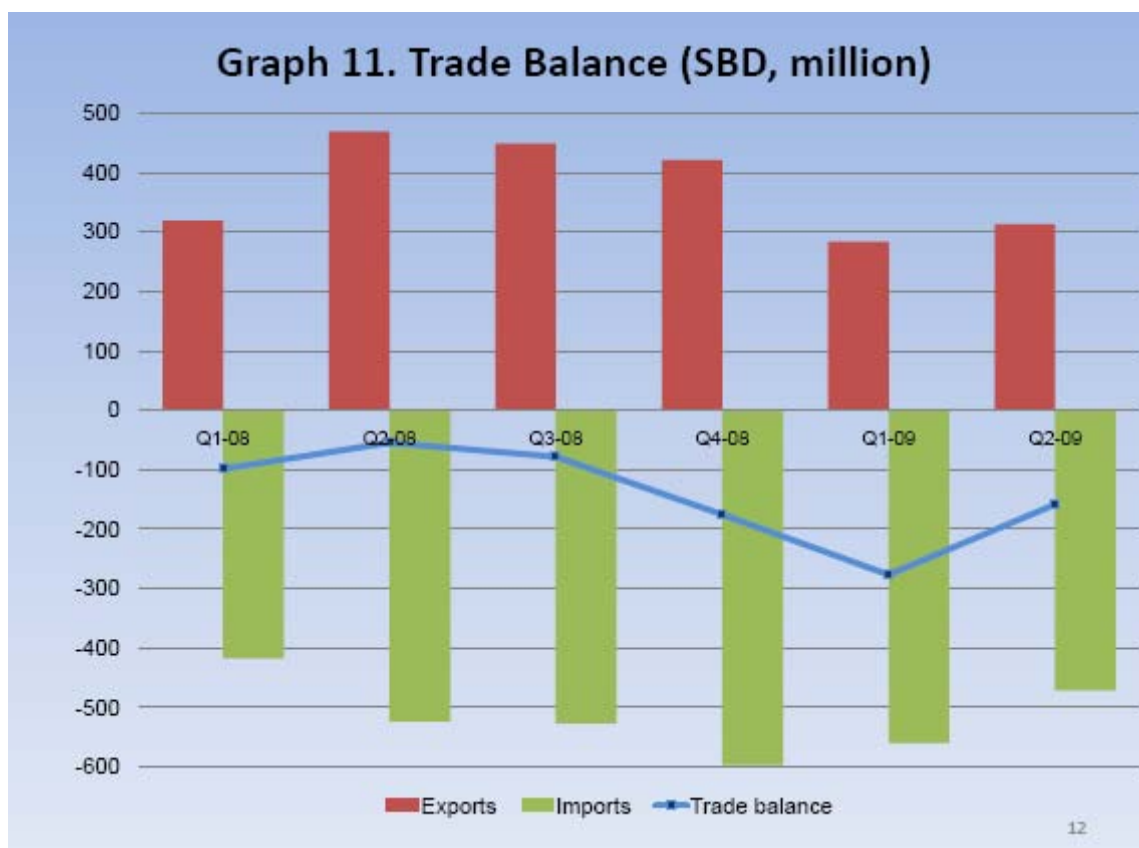
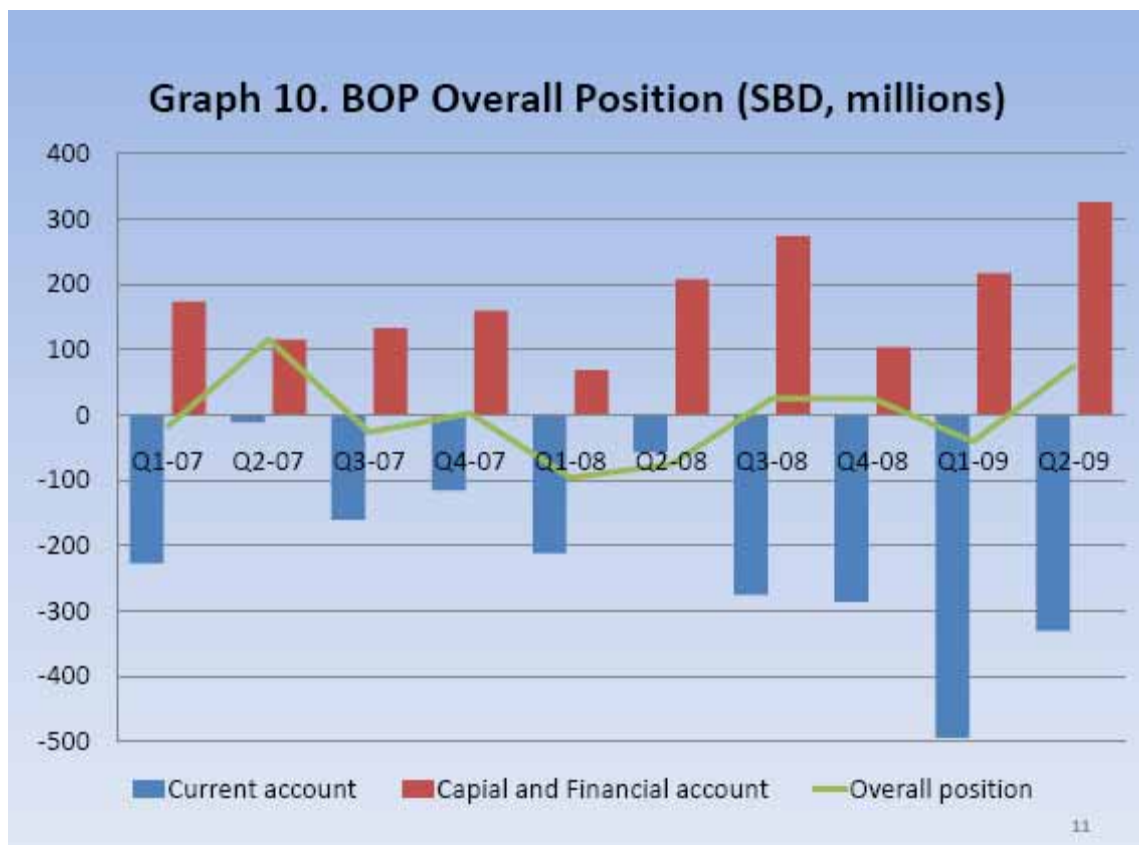
Our second stated policy objective for 2009 was **to protect** and if possible increase **the level of foreign reserves**. At the beginning of the year the level of import cover provided by gross reserves had fallen below the Banks minimum desired bench-mark of 3 months. Through a combination of tight monetary policy, foreign currency inflows and an increase in Solomon Islands' allocation of special drawing rights from the International Monetary Fund, our external holdings have increased to more than four months import cover.



We must however remain cautious as large risks to our external balances persist. Whilst the second quarter of the year saw an improvement in the overall balance of payments position and in fact witnessed a positive overall position, this was based solely on the position of the capital account. The trade balance of Solomon Islands remains in a structural deficit which



without action will only worsen with the decline in logging. The structural imbalance in trade is a major concern and is a key area in which action is required.



The final goal that the Bank set itself for 2009 was **to ensure the stability and robustness of the financial sector in Solomon Islands**. Given the events of the global economic crisis and the financial meltdown across the world, it is understandable that individuals and families in Solomon Islands are worried about their hard earned savings. In this connection, I want to assure the public that the financial sector of Solomon Islands remains secure and well managed. The Central Bank is in the process of bringing in further measures to ensure the continued strength of the sector and to protect investors both now and in the future.

## Issues & challenges

Let me comment on a few issues and challenges facing Solomon Islands. Given the time constraint I have, it is not possible to cover all the issues. I have selected but a few.

The need to find **new sources of growth to replace logging**, is crucial. As yet this remains the great unanswered question for the nation. Solomon Islands must keep striving to develop the areas that it already has and to develop new economic opportunities. Many industries, such as the cattle industry, have not retained pre-tension levels and redeveloping these could be one potential area for growth. Other areas already exist in Solomon Islands and with careful effort and planning could provide future growth. The country must encourage and nurture the spirit of entrepreneurship whenever possible to help the economy to flourish. Developments in the mobile phone market, for example, could present a range of opportunities for local businesses.

Another challenge for our country is our **high population growth**. The population issue in Solomon Islands is like the elephant in the room. We know it is there but nobody wants to talk about it or even acknowledge its presence. Successive Solomon

Islands governments have been unable and even reluctant to address population related issues. But rapid population growth is driving the development agenda in this country from the demand for constitutional change, unemployment, and pressure on infrastructure and social services. Thus it is very important and makes "development sense" to rein in on the population growth in this country as a means of raising per capita income levels and welfare of the people.

The final area I wish to comment on is that of **education**. Education is of vital importance in driving the economy and the nation forward. In order to investigate and change the world we live in it is vital that we have the correct information available to us and that we can correctly interpret and understand it. For this reason events such as this one today are vital to the economic wellbeing of the country and every organization. Every one present here today has something which they can add in this area.

## Conclusion

In concluding, 2009 has so far proved to be a challenging year for the Solomon Islands economy. Although the situation is improving, the Bank predicts that economic growth for the year will be around 1%. There are reasons to be hopeful for the long run prospects of the country, in particular if managed carefully, the agricultural, mining and tourism sectors all have potential as sources of growth. The short to medium term prospect for the economy however look less cheerful and structural reform must be implemented now to avoid a stagnation or worse shrinking of the economy. A warning about how far we still have to go was issued by the World Bank last week when they ranked Solomon Islands 104th in their "ease of doing business" rankings.

Key constraints in Solomon Islands involve weaknesses in infrastructure, insecurity of land rights and difficulties in starting businesses. Reform to these areas is vital to ensure future prosperity.

The Central Bank maintains its commitment to ensuring macroeconomic and financial stability in Solomon Islands and providing an environment where we can grow in a rapid and sustainable way. If all organizations and individuals in the country continue to pull together and work in their own unique way towards the development of this country I am sure that we can continue to improve the state of the economy and the lives of people across the islands.

There is certainly a lot of work to do if we are to improve the livelihood of the majority of our people. And as I alluded to earlier, USP can assist by using its research skills and expertise to finding solutions to these complex issues.

Thank you for your time and God bless Solomon Islands.