Statement by CBSI Governor, Denton Rarawa, at the launch of the 2018 CBSI Annual Report, on 20th May 2019 at the Mendana Kitano Hotel

Salutations

- The Honourable Minister of Finance & Treasury,
- Other Honourable Ministers and Members of Parliament,
- Representatives of the Diplomatic Corps,
- Senior Government officials,
- Central Bank Directors,
- Heads of Statutory Authorities,
- Heads of Financial Institutions,
- Representatives of Non-Government Organizations,
- Representatives of the Private Sector,
- Representatives of the Media,
- Ladies and gentlemen,

It is a pleasure and an honour to warmly welcome you all and thank you for accepting our invitation to the launch of CBSI's 2018 Annual Report. This event is one of the important occasions in the Bank's calendar. It provides me an opportunity to account for the Bank's operations and financial outcomes during the year. However, before I do that, let me first of all present to you an assessment of economic conditions last year, as well as share some food for thought on how we can progress our economy going forward.

At last year's annual report launch, I talked about the need to "reform to transform" our economy after 40 years of nationhood. Today, I want to focus on reforms in the next four to six years. What realistically we could do to move our economy forward. These reforms should drive growth for the next ten years. So, the theme for this morning is about "setting the foundation for robust, broad-based and inclusive growth".

I. Solomon Islands economy in 2018

The Solomon Islands economy witnessed another successful year in 2018. CBSI estimates that the economy grew by 3.9 percent, up from 3.7 percent in 2017. This result was driven mainly by favourable performance in the services sector, particularly from wholesale retail, transport and financial services. The positive outcomes in the primary and secondary sectors (mainly forestry and fisheries) and (construction and manufacturing) also contributed to this growth.

Performance in all key export commodities, with the exception of copra, were positive. Round logs grew by 3 percent to 2.7 million cubic metres last year, the highest level of production on record.

Labour conditions expanded during the year. Based on SINPF data as a proxy employment indicator show an increase of 7 percent to more than 58,000 active contributors. Staffing levels in the public sector rose by 2% to over 17,000 employees. There was also a pickup in both the locally based work force and seasonal workers in Australia and New Zealand.

Consumer price pressures rose in 2018. Headline inflation reached 4.2 percent in December against 1.8 percent at the end of 2017. This rate was within the Bank's forecasted range and was driven by stronger supply-side domestic inflation, along with the rise in imported prices. Categories responsible for the spike in consumer prices during the year were education, transportation, food, and alcohol and tobacco.

External conditions remained firm during the year. Despite a reduction in the trade surplus, improved investment income and tourism receipts narrowed the current account deficit. As a result, the country's gross foreign reserves increased by 10 percent to $5 billion. This level of reserves was sufficient to cover nearly 13 months of imports and is well above the CBSI's precautionary import cover threshold of 6 months.

Developments in the monetary sector also point to sustained growth. Broad money rose by 7 percent to $5.2 billion due to increases in both net foreign assets and private sector credit. Lending by banks to the private sector grew by 4 percent to $2.4 billion during the year. Major borrowing industries were construction, distribution, transportation and manufacturing. Nonetheless, interest rate margins remained high at around 10.5 percent.

Meanwhile liquidity levels in the banking system continued to accumulate, rising by 14 percent to $2.2 billion and was largely driven by the growth in net exports. Excess liquidity remained high, although we believe it is not inflationary, particularly in view of the much lower credit growth and the supply-side nature of inflation in the country.

With respect to government's finances, 2018 was a positive year. The fiscal position returned to an estimated surplus of $191 million after two successive years of deficits, reflecting considerable fiscal consolidation. Revenue in particular rose on strong collection from tax and trade-related duties, while total expenditure only grew marginally, amidst a reduction in development spending. Meanwhile, government debt increased moderately and remained at around 11 percent of GDP.

Turning to the outlook for the economy, CBSI projects the Solomon Islands economy to grow by 3.7 percent in 2019. This moderation in growth reflects the key assumption that forestry will finally decelerate as part of the government's new policy to achieve sustainability in the forestry sector. Nevertheless, growth is expected to be driven by the transportation and construction sectors, related to major infrastructure projects, the onset of mineral production, wholesale retail, manufacturing and fisheries.

Over the medium term, the economy is expected to grow by an average 4.5%. This is expected to come from positive spill-over from projects such as the submarine cable, Tina Hydro, the Pacific Games and projected robust outturns in mining.

However, there are potential risks on the horizon. These include potential slower growth from an uncertain global outlook, the negative impact of climate change and pests on our crops, and an uncertain fiscal stance. Moreover, the narrow economic base would limit the economy's future growth potential and leave it susceptible to a range of shocks.

Now let me briefly account for CBSI's operations in 2018 before I turn to my theme for today **"setting the foundation for robust and inclusive growth"**.

II. CBSI operations in 2018

2018 was also a good year for the Central Bank. Strong performance from investment income and growth in other incomes, led to an operating profit of $84 million. This is more than double the profit of $30 million in 2017. The net assets position of the balance sheet also increased to $149 million at the end of 2018 up from $45 million in 2017.

In terms of its investments, CBSI strategically invested portions of the foreign reserves in secure asset portfolios overseas to generate income and sustain the reserves. Improved financial market conditions and favourable deposit rates, particularly in the United States contributed to the surge in interest income to $86 million from $49 million in 2017.

The Bank's governance was strengthened at the start of the year with the appointment of three new directors to take it to a full complement of nine board members. In September, we farewelled former Deputy Governor Mr Gane Simbe and welcomed Dr. Luke Forau as the new Deputy Governor. At the end of the year, two directors, Mr John Usuramo and Mr Harry Kuma ended their terms. Mr Kuma, of course, is now the new Minister of Finance & Treasury. I would like to thank both of them for their contribution and services to the Bank, and congratulate the new Minster on his appointment. At the same time, let me also congratulate Mr McKinnie Dentana on his appointment as the new Permanent Secretary of the Ministry of Finance and Treasury.

With respect to staffing, the total number of staff in the Bank increased by 4 percent to 159 in 2018. The increase was due to the creation of new positions recommended by an institutional review conducted during the year by a former senior Reserve Bank of New Zealand official. CBSI endeavours to be an employer of choice and continues to recruit talent, and develop its staff through both short and long-term capacity development.

There were some important currency developments during the year. In July, the Bank launched the commemorative \$40 note and a coloured \$2 coin to celebrate the country's 40th anniversary of independence. In August, a new \$5 polymer note was endorsed. This new note was launched for circulation recently on 2nd May 2019 during the World Tuna Day. The Bank plans to progressively update its suite of notes as part of a currency reform process that started in 2010. These are, aimed in part, to enhance the security of the notes and to reflect changes in the economy.

In terms of financial stability, the Bank maintained its supervision and examination of financial institutions to ensure that the financial system remains safe and secure. To that end, one potential risk to the financial system and potentially the country was resolved with the securing of a US dollar correspondent banking relationship (CBR) between one of the commercial banks and an overseas bank.

Reforms to the financial infrastructure were made during the year with the World Bank/IFC assisting the Central Bank to procure key elements of the National Payments System. The accompanying legislation, the National Payments System Bill was tabled in parliament, however could not be enacted due to the dissolution of the 10th Parliament in December. CBSI will work with the new Government to progress this important legislation this year.

With respect to its work on financial inclusion, the National Financial Inclusion Strategy II was reviewed in August by the Pacific Financial Inclusion Program, resulting in a refocus in its strategy. It was also pleasing to note that the Bank was recognized for its work in this space with two awards at the Alliance for Financial Inclusion (AFI) Global Policy Forum in Sochi, Russia. One of the awards was for the Bank's contribution to championing regional efforts to find solutions to the issue of 'de-risking' and the closure of CBRs.

Let me now return to the theme of my presentation this morning.

III. "Setting the foundation for robust, broad-based and inclusive growth"

Following our recent national general elections, we have chosen our leaders for the next four years. With the government now settling in, I would like to encourage all of us, the private sector, non-government organizations, civil society groups, communities and all Solomon Islanders to work with our government as they take us forward.

I also believe this is an opportune time to rethink and strategize how we could realistically map our future.

As we heard earlier, the economic forecast for the next four years is for an average growth of 4.5 percent. However, there are several issues with what would have been quite a positive outlook. **Firstly**, as I have discussed during previous annual report speeches, this rate of growth is far too slow and will not transform our economy. We have a rapidly growing population that will demand more resources and support. We need to address our high population growth.

Secondly, the 1 percentage point increase to 4.5 percent (from 3.5 percent over the past five years) only reflects the major infrastructure projects that will take place in the next few years. Once they are completed, growth is expected to return to its normal trend.

Thirdly, growth has only centred on a few commodities like logs and have been far from inclusive, meaning that people in the rural areas have not benefited from the positive spill overs of development or in pidgin “Mefala rural pipol no lukim nomoa growth ya”.

What should we do?

I will share some thoughts on possible policy directions that could and should be undertaken in the next couple of years.

(a) Robust Growth

To realistically grow the economy without overheating it, we should be growing at an average of 6% over the medium term. To achieve this, we should address structural issues in the economy, and appropriately invest in the growth areas that we can realistically develop and sustain.

Now, Government has successfully made strides in some structural reform areas over the past couple of years, from the business and regulatory environments to communication and taxes which, are being implemented. Nonetheless, more needs to be done.

To grow at 6 percent means it will only take us around 12 years to double growth. Such a growth also has to be inclusive, cross cutting and achievable. So how do we go about it?

(b) Foundations for an inclusive and broad-based economy

To illustrate this point, we could lay the foundations of a broad-based economy by putting more emphasis on agriculture and tourism (without disregarding the other sectors).

Agriculture is an inclusive growth area because most people in our rural areas can participate and benefit from its positive spill overs. To revitalize the sector, we should seriously invest in:

1. **Replanting**. Aside from the current stocks, we need to replenish the stock of our agricultural current commodities over the next three to four years.
    a. For cocoa, the country needs to boost output by an additional 3,000 metric tons per year. This means growing an additional 885 hectares of cocoa plants. And if the country can export 10,000 tons a year, foreign exchange earnings will increase significantly. This will at least reduce the gap in the revenue loss from the expected decline in logging.
    b. To boost copra and coconut oil production, we would need to plant nearly 2 million new coconut trees.
    c. While, palm oil would need an additional 800 hectares. This is only a 12 percent increase from the current acreage of palm oil plantations.
2. **Growing new cash crops**. The country needs to promote the growing and export of promising cash crops, such as kava, cassava and noni, and even delve into new ones like ginger and chilli.
3. **The key stakeholders**. Enhance and properly resource the Ministry of Agriculture, and associated agencies such as CEMA to appropriately support farmers, while also liaising with development partners and programs such as PHARMA.

With respect to tourism, this is a growth sector with cross cutting positive spill overs and can be a catalyst for infrastructure, employment, education, wholesale retail, transport and technology development. As such, Tourism Solomons' target of reaching 60,000 visitors by 2025 is achievable, if we invest in:

1. Around two medium size brand hotels in the country to act as an anchor for the growth of other tourism standard hotels.
2. Better sea, air and land infrastructure around the country to support this industry that would also facilitate trade. The recent opening of Munda for international air services is a commendable start.
3. And as earlier expressed, enhance and properly resource the key stakeholders such as the Ministry of Tourism, and Tourism Solomons, in conjunction with other stakeholders to actively promote this sector.

Now these are just some ways we could shape our economy as we see slowdowns in the forestry industry, and strive to diversify the economy. There are of course other important sectors such as fisheries and manufacturing, where due to time, we may discuss at another time.

Finally, as we rethink about the future of our economy, I would like to encourage the new Government, stakeholders and our development partners to continue the discourse. The key question

I would like to leave with us is, how can my institution, company, constituency and myself contribute to transforming the economy onto a more robust growth path? Because the plans and action today would lay the foundations for the prosperity of our future generations.

And talking about our future generation, investing in our young people is critical. Not only in their education and health but also in creating employment opportunities for them. Greater priority should be accorded to investing in and developing our human capital so that they can make a meaningful contribution to our country.

Conclusion

In conclusion, as I have stated earlier, 2018 was a favourable year for the economy. While the forecasts for the years ahead are positive, the projected growth is still not enough to sustain our growing population. We also need to widen the economic base and make it more inclusive. This is nothing new and has already been articulated in the National Development Strategy 2016-2035, in particular NDS Objective 1. Sustained and Inclusive Economic Growth. We only need to implement it. As such, we really need to “walk the talk” and invest in our key sustainable sectors as a foundation for more robust and inclusive growth.

Finally, may I take the opportunity to thank the various institutions, ministries, SOEs, financial institutions, NGOs and companies who contributed to this report and our work in 2018. As usual the views expressed in this Report are of course entirely the responsibility of the Bank.

I would also like to thank the Auditor General and the contracted external auditors, PricewaterhouseCoopers (PwC) of Fiji for finalising our accounts. Thanks to Skrinhaus, our printer and Kitano Mendana hotel for the venue and other services provided.

A special acknowledgement to the CBSI Board of Directors for their unwavering commitment to the Bank in ensuring effective governance and policy direction. And finally, to my staff for their efforts in achieving the Bank’s mandate.

Ladies and Gentlemen, with these few words, it is my pleasure to commend the 2018 CBSI Annual Report for your reading.

Thank you for listening and May God Bless Solomon Islands.

20th May 2019