Restrictions to contain COVID-19 brought the worst economic contraction in over 2 decades. Lower log output and higher international commodity prices pushed the current account deficit higher. Economic recovery in 2023 will be buoyed mainly by public investment and consumer spending tied to hosting the Pacific Games. While inflation is expected to ease slightly in 2023, the current account deficit is projected to rise further as imports accelerate. Finance and tax reform are laying the foundation for broad-based growth.

Economic Performance

GDP contracted by 4.2% in 2022, the worst result since 2001. Restrictions to contain COVID-19 and the lingering impacts of civil unrest in November 2021 spelled economic contraction for a third consecutive year (Table 2.35.1). After community transmission of COVID-19 was detected in January 2022, restrictions on travel and transportation were quickly implemented. Counter measures impeded the reconstruction and gradual relocation of strife-affected businesses and, as the disease nevertheless spread quickly throughout the archipelago, affected almost all production and consumption. Most restriction were lifted in May, and international borders reopened in July.

COVID-19 restrictions exacerbated a decline in logging output. Logging output contracted by 22% in 2022, the fourth consecutive year of decline (Figure 2.35.1). Exports of logs and timber fell by 20%, driving down export duties from logging by 33%. Yet logging remained a linchpin of the economy, contributing 11% of GDP in 2021. Its performance thus affected manufacturing, transport, and trade.

Table 2.35.1 Selected Economic Indicators, %

<table>
<thead>
<tr>
<th></th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
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</thead>
<tbody>
<tr>
<td>GDP growth</td>
<td>–0.5</td>
<td>–4.2</td>
<td>3.0</td>
<td>2.5</td>
</tr>
<tr>
<td>Inflation</td>
<td>–0.2</td>
<td>5.5</td>
<td>4.5</td>
<td>3.7</td>
</tr>
</tbody>
</table>

GDP = gross domestic product.
Source: Asian Development Bank estimates.

This chapter was written by Prince Cruz, consultant, Pacific Department, ADB, Manila and Dalcy Tozaka of the Solomon Islands Pacific Country Office, ADB, Honiara.
Fishing, a potential engine of growth, also suffered setbacks. The fish catch fell by 6.8% in 2022, but higher global prices kept fish exports almost unchanged (Figure 2.35.2). Similarly, production of other crops declined—copra by 23.9%, coconut oil 26.4%, palm oil 6.8%, palm kernel oil 5.0%, and cocoa 44.4%—but higher prices boosted exports of copra and coconut oil by 22.1% and of palm oil and kernels by 39.3%.

Despite the reopening of Gold Ridge mine, industry growth remained subdued. Gold Ridge, the country’s sole gold mine, reopened in November, helping to more than double mining exports in 2022. However, construction remained weak with stalled infrastructure projects resuming only slowly in the second half of 2022 and imports of machinery and transport equipment fell by 20.0% for the whole year.

Late budget approval and COVID-19 restrictions narrowed the fiscal deficit. Delay in passing the budget to April and movement restrictions slowed fund disbursement, especially for capital projects. Expenditure contracted by 10.0%, with spending on goods and services down by 13.6% and capital spending lower by 18.3%. Meanwhile, revenue from income taxes fell by 2.3% and from goods and services taxes by 4.2%, further constraining revenue already crippled by the plunging duties from log exports. Revenue from international trade other than logs was virtually unchanged as higher fuel prices—and thus duty collections—offset a reduction in the fuel duty in June and its elimination in September. Even with revenue falling by 7.0%, the fiscal deficit narrowed from the equivalent of 5.5% of GDP in 2021 to 3.7% in 2022.

Inflation returned at 5.5% in 2022, reversing 0.2% deflation in 2021. Prices for food rose by 7.7%, transportation 15.6%, and home utilities 7.2%, while those for alcoholic beverages, tobacco, and the price-volatile betel nut fell by 9.0% (Figure 2.35.3). Transportation and home utility inflation would have been higher if not for the fuel duty rate relief. Despite higher inflation, the Central Bank of Solomon Islands has kept its accommodative monetary policy unchanged since March 2020. As the current account deficit widened from the equivalent of 4.8% of GDP in 2021 to 12.4% in 2022, international reserves declined by 5% but remained sufficient to cover 13.7 months of imports, according to the central bank.

Economic Prospects

Hosting of the Pacific Games is likely to spur growth of 3.0% in 2023. Construction, wholesale and retail trade, transportation, food services, and public services are expected to be the major growth drivers (Figure 2.35.4). Held for 2 weeks from 17 November, the games are expected to bring more than 5,000
athletes and staff from 24 nations. Honiara is getting a major facelift with renovations to the airport, roads, and other public infrastructure. Growth is expected to remain relatively robust at 2.5% in 2024 on higher government spending and investment associated with national elections scheduled in April 2024.

The fiscal deficit is projected to widen in 2023 on higher spending for the Pacific Games. Recurrent expenditure is forecast to rise by 19.8% and capital expenditure by 70.1% while revenue, including grants, is expected to rise by only 16.5%. The fiscal deficit is therefore expected to widen to the equivalent of 6.7% of GDP (Figure 2.35.5). Borrowing from development partners will cover about 80% of the deficit, and domestic bond issuance the rest. The deficit is expected to persist in 2024 with logging duties continuing to fall while spending remains elevated with scheduled elections.

Inflation is expected to decelerate in 2023 and 2024 as global price rises ease. In line with global trends, inflation in 2023 is expected to fall to 4.5% but remain elevated with demand associated with the Pacific Games and the expected restoration of import duties on fuel. Inflation is forecast to fall further to 3.7% in 2024. While food and fuel prices follow global price movements, their impact on inflation overall is constrained by price controls in Honiara.

The current account deficit will likely expand with significantly higher imports for the games. Aside from the games, resumed construction on projects financed by development partners is expected to accelerate imports of machinery and construction materials. The decline in logging exports will likely be partly offset by higher mineral exports with gold production in full swing. Despite the increase in imports, the risk of depleted foreign reserves is small because most projects are financed by loans and grants. Higher tourism receipts and remittances from seasonal workers in Australia and New Zealand are also expected to boost the supply of foreign currency.

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**Figure 2.35.4** Supply-Side Contributions to Growth
Expansion in services and industry related to the 2023 Pacific Games is expected to boost growth this year.

**Figure 2.35.5** Fiscal Balance
The budget deficit will widen with higher spending on the Pacific Games despite higher tax revenue.

GDP = gross domestic product.
Sources: Central Bank of Solomon Islands; Asian Development Bank estimates.
Policy Challenge—Promoting Reform of Tax and Payment Systems

A continued decline in logging output aligns with the National Forest Policy 2020. While logging output fell below 2.0 million cubic meters in 2022, it still greatly exceeded the sustainable harvest rate of 250,000 cubic meters. As logging output has fallen, the share of export duties in domestic revenue has shrunk from 20% in 2018 to 10% in 2022 (Figure 2.35.6). As the economy shifts to more sustainable logging output, new engines of growth and domestic revenue mobilization will be needed.

Figure 2.35.6 Domestic Revenue
As logging output has declined, the share of log export duties in revenue shrunk.

[Graph showing domestic revenue components with a decline in log export duties share over time]

The government is embarking on reform to enhance economic efficiency and sustainability. Instead of opting for revenue quick fixes, the government is laying the foundation for broad-based economic development through several reform measures:

- **National Payment Systems Act.** Passed in July 2022, the act provides financial infrastructure toward an electronic fund-settlement process that allows financial institutions and businesses to transfer money safely, efficiently, and quickly. Undertaken in consultation with the central bank, the act is expected to enhance access to affordable digital payment services and thus financial inclusion while reducing reliance on cash. These benefits are expected to promote private sector development.

- **Tax Administration Act.** Passed in August 2022, the act creates a unified tax code that strengthens revenue administration and collection. It is expected to enhance revenue by promoting a fair and efficient tax environment. The revision is in phase one of a comprehensive tax reform program launched in 2017.

- **Value-added and other tax reforms.** Over the next year, phase two of the tax reform program will revise the income tax and introduce value-added tax to replace taxes on goods and services. Reform is expected to broaden the tax base, minimize inefficiency and tax leakage, and enable broad-based economic growth and development.