



▲ Rose Mae, Dmah Russell, and Juniah Laurere own a pineapple stall next to an ADB funded road project on the outskirts of Honiara, Solomon Islands.

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PACIFIC FINANCE SECTOR BRIEFS

ADB PACIFIC LIAISON AND COORDINATION OFFICE

SOLOMON ISLANDS AT A GLANCE (2017)

SOLOMON ISLANDS

While economic growth in Solomon Islands remains broadly steady, it is reliant on temporary and unsustainable drivers, including expansionary fiscal policy and unsustainable logging. The country's economy is set to slow as short-term benefits of these growth drivers fade. Tourism offers a new source of potentially significant economic growth, but it remains largely untapped and faces significant impediments. Steady progress is, however, being made in implementing the Government of Solomon Islands' well-targeted national tourism development strategy.

Solomon Islands exhibits many of the characteristics of a fragile nation. State structures lack the capacity to provide many of the basic functions for poverty reduction, while public service delivery and economic management need strengthening. The bulk of the country's population lives far from major markets, internal dispersion is high, transport infrastructure is weak (although steadily improving), transport costs are high, and transport services are irregular. Other economic constraints include extremely low levels of human development, a small domestic market, and a narrow economic base. Insufficient government capacity, relatively low standards of governance, weak public sector management, and ethnic tensions combine to pose formidable challenges.

Poverty is widespread in Solomon Islands. It is, however, constituted by a lack of essential services and opportunities for employment, rather than severe destitution or hunger. In 2016, Solomon Islands had a per capita gross domestic product (GDP) of \$1,860, one of the lowest levels in the Pacific. Electricity, water, transport, and telecommunication services are not available to a large proportion of the population. Women in Solomon Islands suffer disproportionately from poor access to essential social services and infrastructure, and have limited control over economic resources. Gender disparities are particularly significant in education and health. A strong traditional obligation system functions as a basic safety net, but it restricts women's control of land and limits their access to credit and other economic resources.

Population

620,800^a

GDP (current \$)

\$1.2 billion

Domestic credit provided by the banking sector

(% of GDP)

28.5%^a

Financial system assets

(% of GDP)

89.5%^a

GDP = gross domestic product.

^a Source: Asian Development Bank. 2018. *Key Indicators for Asia and the Pacific*. Manila.

Table 1: Nominal Gross Domestic Product, 2011–2017

	2011	2012	2013	2014	2015	2016	2017
GDP (\$ million)	824.4	918.4	1,014.7	1,046.8	1,026.5	1,071.0	1,154.8
M2 (\$ million)	341.5	416.5	471.9	492.8	527.8	584.7	597.1
M2/GDP (%)	41.4	45.4	46.5	47.1	51.4	54.6	51.7
Private sector credit (\$ million)	159.9	172.8	200.4	230.9	251.0	274.8	300.7
Private sector credit/GDP (%)	19.4	18.8	19.8	22.1	24.4	25.7	26.0

GDP = gross domestic product, M2 = broad money.

Note: Figures were converted from Solomon Islands dollars to United States dollars using the ADB-recognized exchange rates for each year.

Sources: Asian Development Bank, International Monetary Fund, and Central Bank of Solomon Islands.

Table 2: Financial System of Solomon Islands

Type of Institution	Number
Commercial banks	4
Provident fund	1
Credit institutions	1
Insurance companies	4
Insurance brokers	4
Insurance agents	2
Money transfer services	3
Money changer services	10
Other financial institutions ^a	11
Total	40

^a Includes credit unions and a microfinance institution.

Sources: Asian Development Bank and Central Bank of Solomon Islands.

FINANCE SECTOR OVERVIEW

Solomon Islands is only moderately monetized, but the extent of monetization is trending upwards. The ratio of broad money (M2) to GDP is around 50%, but the ratio of private sector credit to GDP remains below 30% (Table 1).

Although the country's private sector is growing, structural bottlenecks remain. Access to finance by the private sector in Solomon Islands is constrained by risk aversion at commercial banks, unclear land rights, systemic difficulties in using most types of collateral for loans, lack of a clearing system outside Honiara, and large infrastructure gaps.

FINANCE SECTOR STRUCTURE

Solomon Islands has a well-developed financial system relative to other Pacific island economies (Table 2). The financial system is dominated by four commercial banks—ANZ Banking Group, Bank South Pacific (BSP), Pan Oceanic Bank (POB), and BRED Bank—and the Solomon Islands National Provident Fund (SINPF). Commercial banks account for 62% of total assets of the financial sector, while the SINPF accounts for 34%. POB, Solomon Islands' only domestically incorporated bank, opened in 2014; Bank South Pacific added the previous Westpac business to its existing operations in 2015; and BRED Bank was licensed to commence operations in 2017. In 2017, BSP received Central Bank of Solomon Islands regulatory approvals to establish BSP Finance operations. There are four licensed insurance companies, four insurance brokers, and two insurance agents.

A small credit union subsector, two credit companies (Credit Corporation and BSP Finance), one microfinance institution, and a small savings-club subsector supplement the commercial banks. The Central Bank of Solomon Islands (CBSI) serves as the primary regulator of the country's finance sector.

Solomon Islands' finance sector assets continuously expanded from 2011 to 2015 (Table 3). Commercial bank assets increased at an average of 14.2% per year over this period. The entry of POB into the banking subsector further expanded commercial bank assets, as it posted 22.3% growth in 2015. Meanwhile, the asset base of Credit Corporation—the first licensed credit institution in Solomon Islands, providing financing to businesses and individuals—has shown consistent strong annual growth. The insurance sector is small in terms of asset values, which have not grown, and credit unions' assets are growing slowly, but account for less than 1% of total sector assets.

COMPOSITION OF CREDIT

The value of loans and advances in Solomon Islands increased by an average of 15.4% each year from 2012 to 2017 (Table 4). Loans to industry grew steadily, with 2014 being an outlier year where loans to industry spiked at more than triple that of 2013. Funding for the services sector grew solidly, by an average of around 12% from 2012 to 2017. During the same period, credit extended to the agriculture sector fluctuated between \$8.3 million and \$12.5 million.

While the majority of the loans—around 36%—remained under mortgage financing and or were for household consumption, the International Monetary Fund (IMF) observed in 2016 that the importance of this situation has diminished because more credit is being channeled to other sectors of the economy, helping contain banks' exposure to the household sector.

FINANCE SECTOR PERFORMANCE

Private sector credit is steadily increasing as the economy grows in Solomon Islands. The quality of this lending has improved over time. Although the nonperforming loan ratio grew to 6.1% in 2017 from 3.8 in 2016, the IMF (2018) noted an improvement to 5.8% in the first quarter of 2018 due to recovery action by banks. It remains lower than the 7.0% recorded at the end of 2013 (Table 5).

Deposit rates remain low, consistent with the excess liquidity in the banking system and banks' caution about lending to small businesses. The gross lending margin of around 10% is high by developed country standards, but consistent with the higher lending risk environment in Solomon Islands.

FINANCIAL INCLUSION

The majority of adults in Solomon Islands remain excluded from the formal finance sector. A survey conducted by the CBSI in 2015 found that 31% of the adult population in Solomon Islands did not have access to any type of financial service, while 35% had accessed informal financial services such as shop credit, moneylenders, or savings clubs. Only 26% of adults had a bank account, while another 8% had an account in another formal financial institution such as the SINPF or a credit union. From a gender perspective, there is a higher degree of financial exclusion among women compared with men. While 32% of men in Solomon Islands hold a bank account, only 20% of women do. Moreover, 36% of women are totally excluded from formal financial services, while there is a lower rate of financial exclusion for men at 26%.

Geographical constraints remain a serious impediment to financial inclusion in Solomon Islands. Although the numbers of bank branches and ATMs have continuously risen since 2013, the IMF (2018) pointed out that the expansion of these services was minimal and not significant to address the wide geographic dispersion of the population, resulting in Solomon Islanders having relatively low access to the banking system compared to residents of other Pacific island countries. However, the growth in mobile banking could expedite the provision of financial services to people in remote areas.

Table 3: Financial System Assets 2011–2015 (\$ million)

	2011	2012	2013	2014	2015
Commercial banks	377.4	436.6	506.4	520.5	636.7
National provident fund	167.3	196.4	311.5	338.9	356.9
Insurance companies	15.2	14.8	15.7	15.9	14.5
Credit corporation	8.8	11.0	14.3	17.0	19.1
Credit unions	6.5	6.3	6.4	6.6	7.4
Total assets	575.2	665.1	854.3	898.9	1,034.5

Source: Central Bank of Solomon Islands (CBSI). 2016. *2015 CBSI Annual Report*. Honiara.

Table 4: Consolidated Loans and Advances (\$ million)

	2012	2013	2014	2015	2016	2017
Agriculture	10.8	11.6	8.3	11.6	10.6	12.5
Industry	34.2	32.3	131.2	40.2	55.8	66.9
Services	124.0	152.8	187.9	195.6	203.8	215.4
Total	169.0	196.7	327.4	247.4	270.2	294.8

Source: Central Bank of Solomon Islands. 2018. *Quarterly Review March 2018*. Honiara.

Table 5: Finance Sector Performance Indicators

	2012	2013	2014	2015	2016	2017
NPL ratio (%)	3.6	7.0	4.7	4.1	3.8	6.1
Deposits (\$ million)	253.3	296.8	281.8	330.4	342.6	358.4
Commercial bank loans to the private sector (\$ million)	168.9	196.7	327.4	247.4	270.1	294.8
Deposit rate (%)	0.9	0.3	0.2	0.3	0.2	0.3
Lending rate (%)	11.3	10.8	10.9	10.5	10.1	10.7

NPL = nonperforming loans.

Source: Central Bank of Solomon Islands and International Monetary Fund. 2018. Solomon Islands: 2018 Article IV Consultation. *IMF Country Report*. No. 18/309. Washington, DC.

Barriers to financial access also include shortfalls in soft infrastructure. While Solomon Islands has hard infrastructure deficiencies, such as the limited availability of financial access points due to the scattered geography of the country, there also are soft infrastructure deficits that are seriously inhibiting access to financial services. Among Solomon Islands population who are unbanked, 45% indicated that they lack knowledge about how to use a bank account. The CBSI (2016) reported that there are significant correlations between both income and financial inclusion, as well as lack of schooling and financial exclusion.

Meanwhile, the volume of the finance sector of Solomon Islands has continued to deepen. The IMF (2018) observed that the ratio of domestic bank deposits to the country's output continuously improved from 2005 to 2015. Despite a slight decline in 2016, the latest figures indicate that domestic bank deposits now represent around 40% of the country's GDP.

Table 6: Financial Access Indicators

Access Indicators	2012	2013	2014	2015	2016	2017
Number of bank branches	10	9	10	11	12	12
Number of ATMs	38	38	39	41	42	45
Number of depositors with commercial banks	98,598	84,543	152,348	162,187	178,090	193,564
Number of deposit accounts with commercial banks	99,675	84,543	156,459	172,167	185,810	200,467
Number of borrowers at commercial banks	5,272	12,126	13,763	9,647	10,709	10,131
Number of loan accounts with commercial banks	14,173	12,126	13,823	13,921	11,004	10,356

Source: International Monetary Fund. 2019. *Financial Access Survey*. Washington, DC.

In addition, the number of deposit accounts expanded steadily from 2013 to 2017 at an average of 27.7% per year, while the number of depositors increased by an average of 26.2% during the same period (Table 6).

Yet, private sector credit remains insufficient. Although private sector credit in Solomon Islands has been growing over time, the Asian Development Bank (ADB) observed in 2016 that the magnitude remains much lower than in other Pacific island economies. The ratio of private sector credit to GDP in Solomon Islands averaged 22.3% from 2011 to 2017—lower than the global average and one of the lowest in the Pacific. Countries such as Fiji, Samoa, Tonga, and Vanuatu fared much better than Solomon Islands. For example, Tonga, which has the next lowest average after Solomon Islands, posted an average ratio of 34.2% from 2011 to 2017.

CHALLENGES AND ISSUES IN THE FINANCE SECTOR

Insufficient credit provision in Solomon Islands is likely due to two main factors: weaknesses in the collateral framework and difficulties in assessing risk.

- (i) **Insufficient collateral, due to land title complexities, hinders many businesses from obtaining credit.** The prevalence of unregistered land in Solomon Islands makes land an undesirable form of collateral for the country's banks. In fact, even if land has been registered, ADB (2016) observed that banks are still hesitant to accept it as collateral, unless it is held in a fixed-term estate. Banks can also encounter difficulties in the court system when taking ownership of registered land in the event of a loan default. As such, banks lean towards personal guarantees and standing orders for loan repayments from accounts of pensioners or government employees.

- (ii) **Difficulty in assessing risk provides another hurdle to private sector lending.** ADB (2016) cited anecdotal evidence that suggests poor business record-keeping and accounting practices make it more difficult for lenders to assess the risk of potential borrowers. A credit bureau was launched in Solomon Islands in February 2015 and is managed by the Credit and Data Bureau of Papua New Guinea. ADB noted the success of the credit bureau in collecting credit information from retailers, trade creditors, or utility companies, as well as financial institutions. It now covers 200,000 individuals and 18,000 businesses. This rich financial data on creditworthy consumers will be a valuable tool in expediting loan applications and expanding credit in the economy.

Reestablishing a development bank in Solomon Islands requires careful assessment. The former Development Bank of Solomon Islands ended its operations in 2004 after experiencing severe liquidity and solvency issues (ADB 2016). Its demise was caused largely by the conflict between equity and efficiency policies. As a development bank, to promote the government's social equity program, the former Development Bank of Solomon Islands provided credit to the agriculture sector and other more vulnerable sectors. Yet, as a former finance minister observed, such policies usually go against sound commercial banking principles.¹ With many other countries sharing the same experience, any plans of reestablishing a development bank in Solomon Islands must be carefully evaluated. ADB (2016) offered as an example the case of the National Bank of Vanuatu. The National Bank of Vanuatu is a domestic commercial bank that has managed to establish an extensive branch network throughout the country, providing microfinance loans for micro and small enterprises, on top of the usual banking services it offers.

¹ Statement made by the Minister of Finance and Treasury Gordon Darcy Lilo, which was quoted in ADB (2016).

Other issues relate to modernizing the country's financial

system. Given the geographic dispersion of Solomon Islands, the deployment of branchless banking provides an alternative to delivering formal financial services to remote areas. While progress has been made on branchless banking, some concerns remain. These include the huge costs attached to supporting bank agents across a widespread area with small population bases as well as the security risks associated with moving cash between remote agents and commercial bank branches in major cities. Another issue pertains to enhancing the country's payment system. The current manual method for settling interbank transfers is both time-consuming and risky. Although the CBSI has already taken steps to address the problem and establish a national payments system, one possible stumbling block cited by ADB (2016) is the negotiation of interchange fees among commercial banks for the use of each other's infrastructure.

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