MINISTRY OF FINANCE & TREASURY

MEDIUM TERM DEBT MANAGEMENT STRATEGY

2025-2027

OCTOBER 2024

Contents

Abbreviations

ADB	- Asia Development Bank
ATM	– Average Time to Maturity
ATR	– Average Time to Refix
COMSEC	– Commonwealth Secretariat
DMAC	– Debt Management Advisory Committee
DMS	- Debt Management Strategy
DMU	- Debt Management Unit
DSR	- Debt Servicing Reserve Account
DSA	- Debt Sustainability Analysis
DSF	- Debt Sustainability Framework
EU	- European Union
GDP	- Gross Domestic Product
IDA	- International Development Assistance
IFAD	- International Food and Agriculture Development
IMF	- International Monetary Fund
JICA	- Japan International Cooperation Agency
MoFT	- Ministry of Finance & Treasury
MTDS	- Medium Term Debt Strategy
PFM Act	- Public Financial Management Act 2013
PFTAC	- Pacific Financial Technical Assistance
SI	- Solomon Island
SIG	- Solomon Island Government
T-Bill	- Treasury Bill
WAC	- Weighted average costs
WB	- World Bank

Foreword

Strengthening public financial management is the main priority of the Government of National Unity since coming into power in early 2024. Strong political will, sufficient capacity, ability to adapt to local circumstances, and accountability of institutions are all critical for PFM effectiveness in Solomon Island (SI). Solomon Island is seizing this opportunity to embark on broad economic and institutional reforms. It is vital for SI to strengthen debt management capacity and improve debt transparency at this juncture of new opportunity for the country.

In line with tightening legal and institutional framework; the formulation of the Medium-Term Debt Strategy (MTDS) guides the entire borrowing process to ensure lowest possible cost and prudent levels of risk of the country's debt portfolio. Accessing low-cost concessional financing from bilateral and multilateral sources, while employing international standards when it comes to transparent budgeting, the government aims to build confidence in the economic outlook of the country.

The Government (SIG) has taken important steps to strengthen its debt management capacity. The Public Financial Management Act (PFMA, 2013) defines the authority to borrow, issue guarantees, recording, reporting and auditing requirements, and the PFM regulations issued in December 2013 operationalize the Act primarily to support macroeconomic framework, public funds management, auditing, reporting and overall PFM.

The MTDS provides a framework which guides the Government on the most beneficial financing mix to achieve a debt portfolio that is affordable in terms of cost and risks. This systematic approach to debt management will, in the medium to long run, help the Government acquire better financing terms from development partners, improve Solomon Islands credit rating, and assist in attaining fiscal sustainability amongst other achievements. It is also expected that the Strategy document can become a useful tool to engage with domestic investors.

This MTDS will provide the Debt Management Advisory Committee (DMAC) with the tools to process and approve all requests for financial support from the Government. This MTDS will be supported by the various Guidelines for Direct Borrowing, Sub-national borrowing, Government guarantee and on-lending. The Strategy will strengthen the quality of public debt management and reduce country's vulnerability to international financial shocks and costly financing arrangements.

I wish to acknowledged the PFTAC for providing Technical support to the MOFT on the formulation of the 2025-27 MTDS. The implementation of the 2025-2027 MTDS will therefore provide guiding principle to ensure prudent acquisition of debt within a suitable cost and risk framework to support the Government's development agenda in line with the provisions of public financing strategy and continued fiscal consolidation.

MINISTRY OF FINANCE AND TREASURY SOLOMON ISLANDS

Hon. Harry Kuma (MP)

Minister of Finance and Treasury

I. Introduction

1.0 **The MTDS presented here is the official governance strategy for debt management in Solomon island**. This is the second review of the Medium-Term Debt Strategy (MTDS) following its initial launching in 2012 and current framework being effective from 2019. All borrowing operations of the SIG will be conducted through this 2024 Debt Management Strategy and it forms the underlying basis for direct borrowing by SIG. It covers the period from 2025 to 2027.

2.0 **The MTDS provides a framework within which the Government can make informed choices on how its financing requirement should be met**, while considering cost and potential risks pertaining to different debt instruments. This systematic approach to decision making has strengthened the debt management function and enhanced analytical capacity of staff and helped reduce operational risks. From now onwards, the SIG will update the MTDS every year in fulfilment of Section of the Public Finance Management Act (Section (60). The strategy is prepared taking into consideration projected financing terms of anticipated new borrowing, the type of borrowing and the associated risks or shocks that may impact the Government's ability to meet its debt obligations. It also considers global and domestic economic and financial developments. Several alternative financing options are evaluated under consistent macroeconomic assumptions, economic outlook and shock scenarios to help in the selection of the most adequate option.

3.0 **The objective of the MTDS is to assist Government officials and specifically for DMU to prudently manage, report, assess and take account of all borrowings that the Central Government enters into**. The Framework will strengthen the quality of public debt management and reduce country's vulnerability to international financial shocks and costly financing arrangements. The Guidelines should be considered within a broader context of the factors and forces affecting a governments liquidity more generally, and the management of its balance sheet.

4.0 **DMAC will use this DMS guideline to approve all financing requests table before the Committee**. The DMAC oversees and enforces the criteria of this Debt conditions in all submission and financial packages that are submitted for Solomon government approvals, fulfilling all key requirements of the Framework by ensuring prudent management in all borrowing arrangements. By aligning to the DMF, it supports the vision of the Government in maintaining a sustainable public debt position in the medium term.

5.0 **Public Debt should be managed with a forward-looking approach**. This entails consideration of medium and long-term risks as well as costs. By aligning to the MTDS, this will enable DMU to build more resilient debt portfolios; develop risk mitigation techniques such as liquidity buffers and communicate such adjustments with market and related stakeholders. For MTDS to be effective, the Medium Term Fiscal projections should re-align with economic assumptions used in the MTDS. However, the Government of the day has final say in the fiscal strategies to be adopted that would be bring about growth and sound economic development. In most cases this comes with heavy cost of borrowing.

II. Legislation Governing Debt Management Operations

6.0 Solomon Island's existing legislation is sound, transparent and effective in the management, reporting and evaluation of public entities liability operations. The PFMA 2012 that was approved by Parliament is the main legal document for the effective management and contraction for all direct borrowing, guarantee and on-lending

7.0 Sound governance practices are essential for government debt management because of the size of government debt portfolio and the balance sheet risks that often accompany them. Public disclosure of the government debt management objectives and the responsibilities of the government debt managers is essential for developing a credible debt management mandate and establishing accountability for achieving it.

8.0 The specifics details of borrowing, types of instrument, approval authorities are well specified in the Public Finance Management act. The Minister of Finance:

- has sole power to enter into Government borrowing on behalf of the Government; and
- is required to provide consent to provincial governments, SOEs and the Honiara City Council for any Government borrowing they intend to undertake.

Having a single authority to enter into Government borrowing promotes:

- accountability in decision making;
- transparency in decision making; and
- assessment of competing borrowing proposals on a comparative basis

9.0 Establishment of DMAC required by the Act.

The PFMA requires the Minister to create a DMAC and:

- the DMAC must comprise of executives from MoFT, CBSI and MDPAC; and
- the Minister is required to consult the DMAC before exercising power to authorize, or provide consent for, Government borrowing.

10.0 Setting Annual Borrowing Limit (ABL)

The PFMA requires the Minister to include an ABL as part of the Annual Appropriation Act for any financial year. This requirement for an ABL imposes borrowing discipline on the incumbent Government and promotes an efficient allocation of Government borrowing.

11.0 Mandatory to establish and transfer funds to the Debt Servicing Account (DSA)

The PFMA requires the Minister to create a debt servicing account at the Central Bank Solomon Islands (CBSI) for the purpose of discharging statutory debt. Funds on deposit in the Debt Servicing Account can only be used to discharge statutory debt.

The Minister is also required to set aside a predetermined amount of annual revenue to the Debt Servicing Account. The amount to be set aside must be included in the annual Appropriations Bill, and is therefore a legally enforceable amount.

12.0 Direct Borrowing by Government is solely to finance Infrastructure and NOT Budget Deficit

The PFMA restricts the Minister from borrowing to finance planned budget deficits in the recurrent expenditure. Furthermore, the PFMA prescribes that the Minister shall only enter into new borrowing for high priority infrastructure and development initiatives in line with the Government's development and debt policies. The bridging of any deficit gaps will be through domestic revenue and budget support.

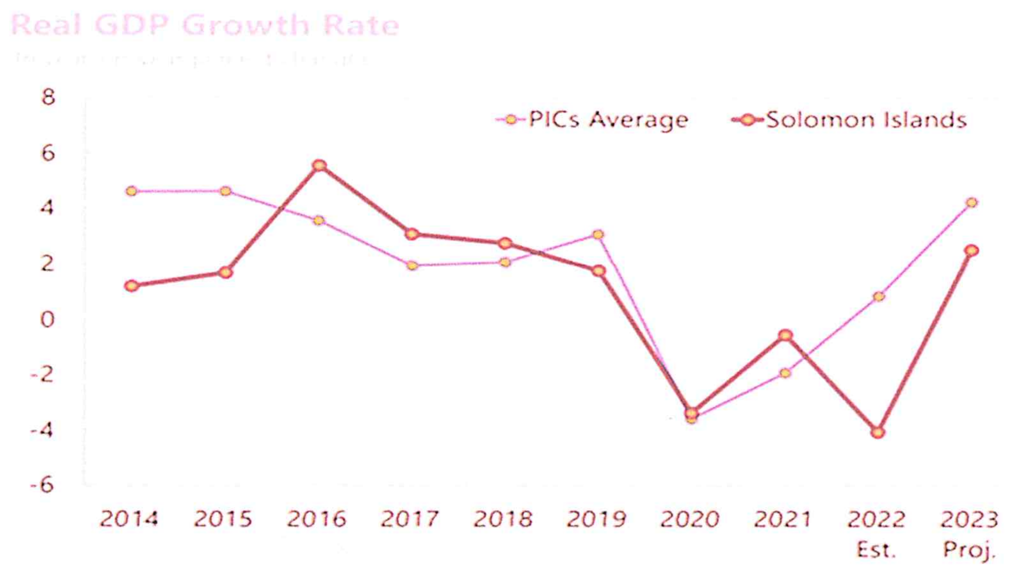
Simply all maturing debt are fully settled and there is no rolling over. New borrowings are specifically aimed at financing SIG infrastructure projects.

III. Performance of SI Economy and Debt Status

13.0 The period 2019-2023 was a challenging one both globally and nationally due to the pandemic and world economy in recession. Business was down and economic activity focused on few major industries such as logging, fishing and palm oil. The Solomon island economy grew by 1.5 percent in 2020, contraction of 2.2 percent in 2021 as well as 2.3 percent in 2022.

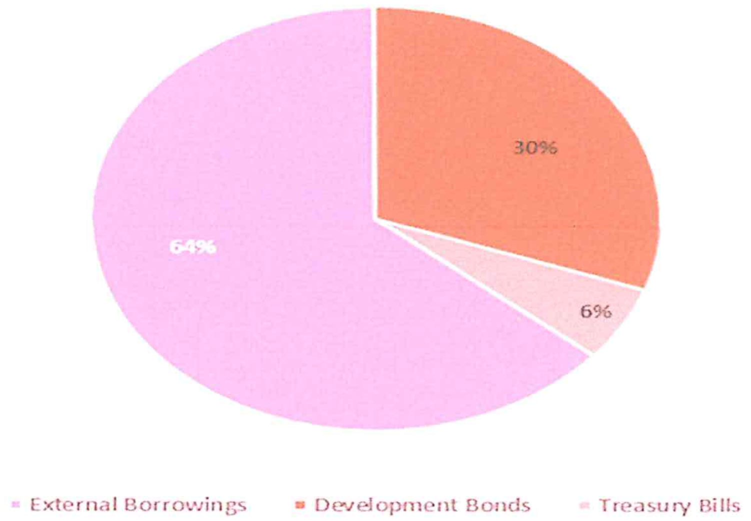
14.0 Business and service activities, particularly Pacific Games and Tina hydro, are expected to support an economic growth of 2.4 per cent in 2023. In terms of contribution to growth, Services and industry sectors are expected to contribute by 2.4 per cent and 0.9 per cent, respectively, in 2023. As a result of projected decline of logging, primary sector is projected to contribute by around 0.4 per cent in 2023, this is supported by the expected increase of business activities, agriculture and fishing outputs in the near term.

After the rebound in 2023, Solomon Islands growth is expected to grow at around 2.5 percent in average in 2024 and into the medium term.

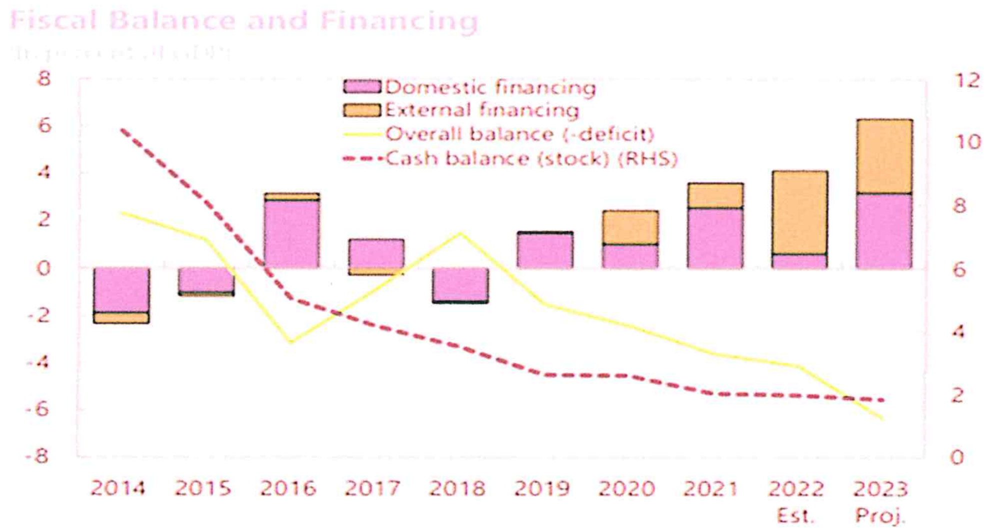


15.0 The Central Government Debt at the end of December 2023 was $2,810.4 million, which was 30 percent higher than 2022 levels. Of the total, $1,618 million comprise of External Debt and $1,192 million domestic debt.

Borrowing by Funding Source



Public Debt as Percentage of GDP



16.0 **Debt Ratio as percent of GDP at the end of December 2023 was 19 Percent.** The Public-Debt-to-GDP ratio increased significantly during the pandemic from 7.9 percent in 2018 to an estimated 19 percent in 2023. When compared to preceding year, the Debt/GDP ratio declined by 1 percentage point. The major factor attributing to rise in Debt ratio is the contraction of new loans from abroad. Furthermore, the Government raised $240 million bonds domestically that were contracted via Private Placement arrangements.

17.0 **Annual Borrowing Limit**: For FY2024, the Annual Borrowing Limit was $558 million compared with $885 million in preceding year. For 2024, SIG had earmarked $258 million to be sourced from external financing based on active loans that were signed and approved by DMAC and Minister in previous years. The balance of $300 million are to be sourced locally, through issuance of medium to long term bonds. While foreign loans have fair well compared with budget, the domestic financing has faced many challenges which will be highlighted later in the document. With these additional loans, DMU anticipates the outstanding Debt by 31 December 2024 to be around $3,270. 8 million.

18.0 **Cost and Risk Analysis of Current Portfolio as of end 2024**

Table 1 below reflects the costs and risks of the existing portfolio at the end of 2024 that serves as basis for preparing 2025-27 debt management strategy.

Table 1: Cost and Risk Indicators for Existing Portfolio

COST AND RISK INDICATORS AS AT END 2024				
Risk Indicators		External debt	Domestic debt	Total debt
Amount (in millions of SBD)		1,988.1	1,282.7	3,270.8
Amount (in millions of USD)		237.0	152.9	389.9
Nominal debt as percent of GDP		14.6	9.4	24.0
PV as percent of GDP[1]		8.7	9.4	18.2
Cost of debt[2]	Interest payment as percent of GDP[3]	0.1	0.4	0.5
	Weighted Av. IR (percent)	0.8	4.3	2.1
Refinancing risk[2]	ATM (years)	14.5	2.7	10.0
	Debt maturing in 1yr (percent of total)	2.4	29.1	12.7
	Debt maturing in 1yr (percent of GDP)	0.4	2.7	3.1
Interest rate risk[2]	ATR (years)	14.5	2.7	10.0
	Debt refixing in 1yr (percent of total)	2.4	29.1	12.7
	Fixed rate debt incl T-bills (percent of total)	100.0	100.0	100.0
	T-bills (percent of total)	0.0	15.3	5.9
FX risk	FX debt (percent of total debt)			60.8
	ST FX debt (percent of reserves)			0.9

The Debt to GDP ratio, at the end of 2024, is estimated at 24 percent taking into account new disbursements from Tina Hydro projects, UWSSSP, SIRAP 1 and SIRAP 2 and Exim China PRC loan for the National tower projects. The PV of total debt as percentage of GDP is 18.2 percent, and foreign debt comprise about 61 percent. The total debt's ATM at the end of 2024 was 10 yrs, compared to ATM for domestic debt at 2.7 years whereas external debt's ATM at 14.5 years. The higher ATM for external reflects the longer-term nature of concessional loans. In terms of costs, the weighted average interest rate for the whole portfolio at the end of 2024 was 2.1 percent and interest payments as percentage of GDP was 0.5 percent.

IV. Medium Term Debt Management Strategy

Objective and Scope

19.0 The debt management objectives of SIG are to ensure that:

a) the financing needs of Government are met on a timely basis;
b) borrowing costs to Government are as low as possible over the medium to long term, consistent with a prudent degree of risk;
c) the development of the SI domestic debt market is promoted; and
d) any other action considered to impact positively on the public debt; and the primary and secondary domestic market

This MTDS covers the period commencing from the financial year 2025 to 2027.

Scope: In terms of coverage, this strategy covers central government debt and does not include borrowing by local government and public corporations. Additionally, since our guaranteed debt is below 3% of the GDP, the materialization of the contingent liabilities arising from guarantees is also excluded from this strategy. For instrument coverage, the strategy only covers debt securities and loans.

Description of Analysis

20.0 In formulating the 2025-27 debt management strategy and the annual borrowing plan, four alternative borrowing strategies were developed and assessed based on uniform macroeconomic and market rate assumptions. When formulating the MTDS, the MOFT assesses the costs and risks of four contender's debt management strategies for fiscal years 2025-27 under various costs and risks assumptions as highlighted in Table 2 below.

Key Assumptions and Forecasts

21.0 In addition to a baseline scenario, the analysis considers some relevant interest and exchange rate shock scenarios to assess their impact on the different borrowing strategies. The concept of prudent degree of risk is premised on the desire for the government to borrow with regard to its ability to pay in the medium and long run.

Baseline Projections of Market Variables

22.0 The 2025-2027 MTDS is prepared in line with the objectives and policy priorities in the 2024 Budget Statement, policy priorities of the GNUT Government and the National Development Strategies. Guided by the medium-term policy objectives, the following macroeconomic targets are set for 2025-2027:

- Real GDP growth is projected at 2.5 per cent in 2024 and increase by 3.1 per cent in 2025 and same level in concurrent years. Estimates for following years is projected around same level with Government beginning to realize investment in infrastructure and key sectors of the economy;
- Inflation is forecast to be around 3-4 % in 2025 and grow at a historical average of around 5-6 percent over the medium term taking into account the continued uncertainty in commodity prices abroad;
- primary balance to record a deficit 1 percent of GDP in 2025. The primary balance is expected to improve further to a 1.5 percent of GDP from 2026 onwards;
- baseline exchange rates are presumed to be constant experience an annual devaluation of about one percent during the 3-year period.
- Baseline interest rates:

  For all multilateral loans, the interest rates and durations will remain unchanged during the period as these are not expected to be affected by market conditions. .

  For other external bilateral loans from Exim China, JICA, the interests are anticipated to be slightly higher than concessional loans from multilateral in line with the existing lending terms. As with multilateral borrowing, the borrowing terms are expected to remain unchanged during the period.

  Domestic interest rates are projected to remain higher than external loans, with medium to longer term loans being closer to current yield. T-bills rate are

Table 2: Baseline Macro Assumptions (SBD $Millions)

FISCAL PROJECTIONS	2024	2025	2026	2027
SBD millions				
Budgeted Revenue and Grants	3,471	3,675	3,680	3,706
Budgeted Primary Expenditure	3,945	4,181	4,186	4,216
Total Expenditures including budgeted interest payments	4,047	4,286	4,291	4,321
Budgeted interest payments	102	105	105	106
International reserves (USD million)	672			
GDP	13,618	14,421	15,292	16,328
SBD millions	2,024	2,025	2,026	2,027
Revenues, grants, & other items	3,471	3,675	3,680	3,706
Non-budgetary assets that reduce gross financing requirement				
Total Cash-flow				
Use of existing funds/deposits				
Privatization proceeds/asset sales				
Other				
Available Amount (%)				
Use of existing funds/deposits				
Privatization proceeds/asset sales				
Other				
SBD millions	2,024	2,025	2,026	2,027
Expenditure & other items	3,945	4,181	4,186	4,216

23.0 The MTDS takes into account the existing fiscal policy stance of the Government and the approved ABP; that takes into account future financing commitments and potential projects for funding.

Table 3 reflects the results of each strategies and the outcome it generates based on debt instruments utilized and their respective assessment:

Table 3: Results of Strategies Assessment

Strategies	Debt Instruments Utilized	Outcome
S1 – Objective of this strategy is to assess the cost and risk indicators of the Government's debt portfolio at the end of the period if borrowing takes place using the same proportions as current practices (60/40). This borrowing strategy will be used as the bases for comparing the other strategies.	External loans sourced mostly from multilateral and bilateral institutions. More incline towards multilateral for its high concessional conditions. Assumes a net domestic issuance of SBD millions 55, 60, 52 in 2025, 2026 and 2027 respectively, in line with current experiences. These levels translate into a 60/40 financing coming from external/domestic sources as follows: External – following current flows mostly highly concessional and concessional sources. Domestic – following current flows as well where half of domestic financing is coming using T-Bills and the other half using long maturities T-bonds	This strategy: (i) takes advantage of concessional nature of financing provided by multilateral and bilateral lenders; (ii) supports the development of the domestic capital market by constant floatation of T-bills and Developmental bonds.

S2 - Objective of this strategy is to assess the cost and risk indicators of the Government's debt portfolio at the end of the period if borrowing takes place using higher proportion of T-bills in the domestic financing (corresponding with lower long term bonds).	Assumes the same net domestic issuance and therefore same external/domestic distribution in the first year of the strategy. External composition is the same as S1 Domestic composition relays more on T-bills in and grows through the period from 60 to 70 percent in the last year. The remaining domestic borrowing takes place using long term developmental bonds.	This strategy: (i) takes advantage of concessional nature of financing provided by multilateral and bilateral lenders; (ii) increases the public debt portfolio's exposure to refinancing and interest rate risks by the increase issuance of T- bills; (iii) anticipate weighted average costs to fall as T-bills rate will push costs downwards.
S3 Objective of this strategy is to assess the cost and risk indicators of the Government's debt portfolio at the end of the period if borrowing takes place with a slight substitution ofT-bills and Long term bonds for short/medium term bonds in the domesticmarket.	Borrowing from offshore be minimized, reduction of 20%. Assumes the same net domestic issuance and therefore same external/domestic distribution in the first year of the strategy. External composition is the same as S1 Domestic composition relays less on T-bills and long term bonds and the difference is picked up by short and medium term bonds	This strategy: (i) takes advantage of concessional nature of financing provided by multilateral and bilateral lenders; (ii) there is a slight decrease the public debt portfolio's exposure to refinancing and interest rate risks by gradually replacing T-bills with short and medium term bonds.
S4 – Objective of this strategy is to assess the cost and risk indicators of the Government's debt portfolio at the end of the period if borrowing takes place almost exclusively from external sources (90 percent).	In this strategy 90 percent of financing takes place from external side. The remaining domestic issuance is limited to T-Bills. This borrowing strategy, although largely unrealistic, would show impact if domestic demand for developmental bonds would collapse. External composition is the same as S1 Domestic composition relays exclusively on T-bills. The SIG currently issues 91, 182 and 365 days Bills which is usually over-subscribed. This strategy allows Government to raise more TBills in the local market that has attracted significant interests from commercial banks, institutional investors and individuals	This strategy: (i) relays on securing additional financing provided by multilateral and bilateral lenders. It involves increased foreign currency risks; (ii) reduces the public debt portfolio's exposure to refinancing and interest rate risks by securing long term financing from external sources (iii) increases the public debt portfolio's duration and raises interest rate risks for T-Bills; (iv) pressure on cashflow position to refinance maturing T-bills.

24.0 Table 4 shows the average percentage of gross borrowing using the various instruments over the 2025-2027 period. Strategies one (S1) through three (S1 to S3) use roughly the same external/domestic borrowing percentage. Only strategy 4 assumes a much higher percentage of external borrowing (90 percent). Within the first three strategies, strategy 1 is used as the basis with the existing 20 percent of T-bills in domestic debt issuance. S2 then assumes an increase in T-bills issuance (31 percent) and S3 assumes a decrease in issuances (13 percent).

Table 4 Average Percentage of Gross Borrowing over simulation period

New debt (in percentage of the total borrowing 2025-2027)		**S1**	**S2**	**S3**	**S4**
XDR Concessional Loan Long Fixed	FX	13	12	13	21
USD High Concessional Loan Long Fixed	FX	26	24	27	42
USD Concessional Loan Long Fixed	FX	7	6	7	11
USD Concessional Loan Medium Fixed	FX	5	5	6	9
CNY Concessional Loan Medium Fixed	FX	5	5	5	8
JPY Concessional Loan Medium Fixed	FX	0	0	0	0
SBD Market T-bill Short Fixed	DX	20	31	13	10
SBD Market T-bond Short Fixed	DX	1	1	5	0
SBD Market T-bond Medium Fixed	DX	3	2	4	0
SBD Market T-bond Long Fixed	DX	21	14	21	0
External		56	53	57	90
Domestic		44	47	43	10

25.0 The Figure 1 chart illustrates the composition of the financing flows from the debt instruments in the utilized in each Strategy- expressed as the annual average share of total gross borrowings in the next 3 years for which the Strategy is being adopted. A detailed analysis of the resulting cost and risk indicators is provided below.

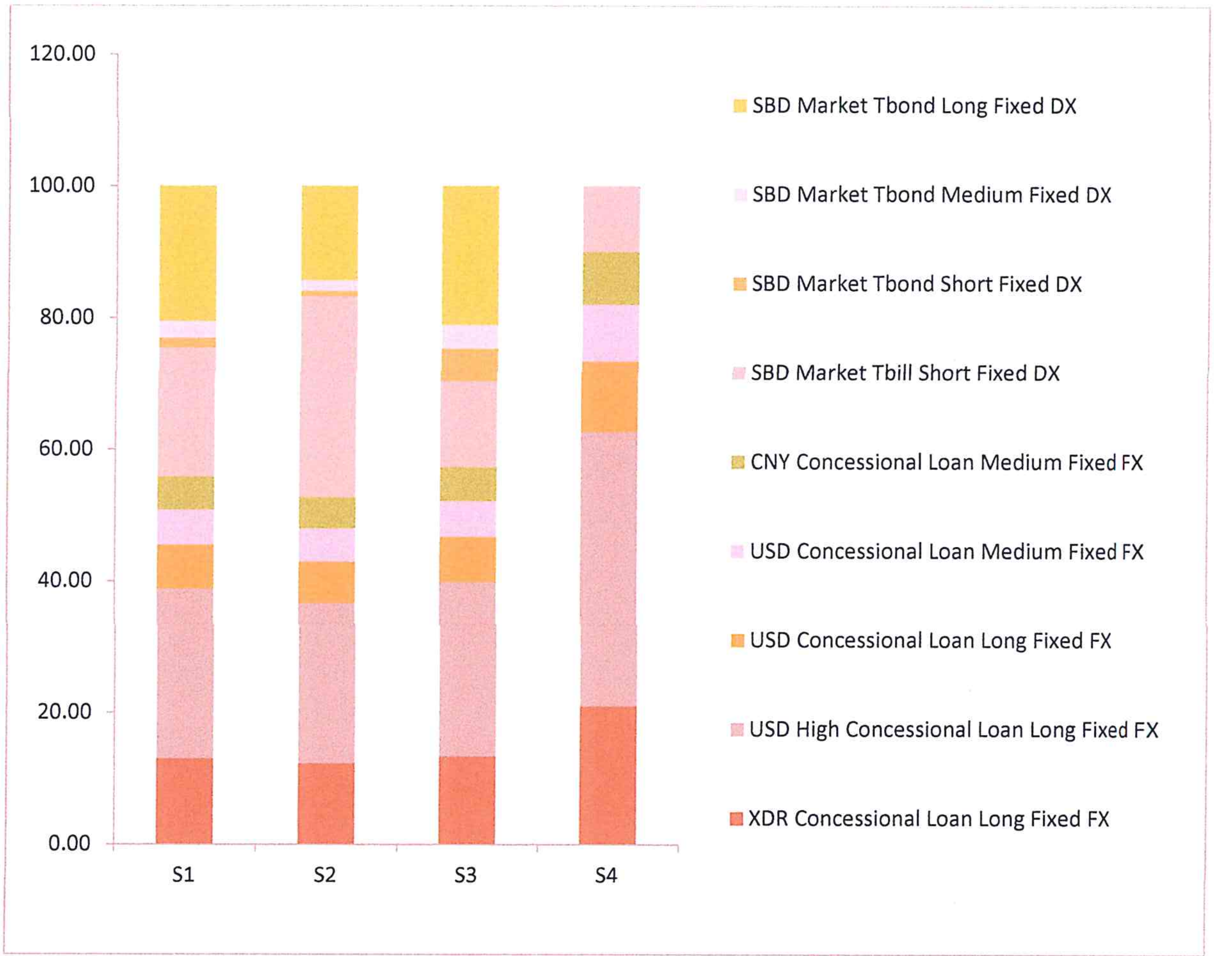
Strategy 1 represents the status quo, and it is used in the analysis as the basis for comparing the other strategies. As such, it reflects the existing borrowing practices and shows the current 60/40 external/domestic financing flows.

Strategy 2, on the other hand, shows the impact of a reduction in the domestic investors' appetite for medium and longer-term T-bonds and assumes an increase in the issuance of T-bills as a means to secure the necessary domestic financing. It shows a slight reduction in cost, compared to strategy 1, but an increase in refinancing and refixing risk.

Strategy 3, shows a reduction in T-bills issuances, compared to strategy 1. This reduction is then compensated with an increase in the short and medium term T-bonds. This strategy has the potential to develop the domestic debt market as it provides more options, in terms of maturities, to the domestic investor. It is, however, considered somewhat unrealistic because, at this point in time, as most of the investors' interest is in T-bills. It shows an improvement in refinancing risk while cost and other risk indicators remain similar to Strategy 1.

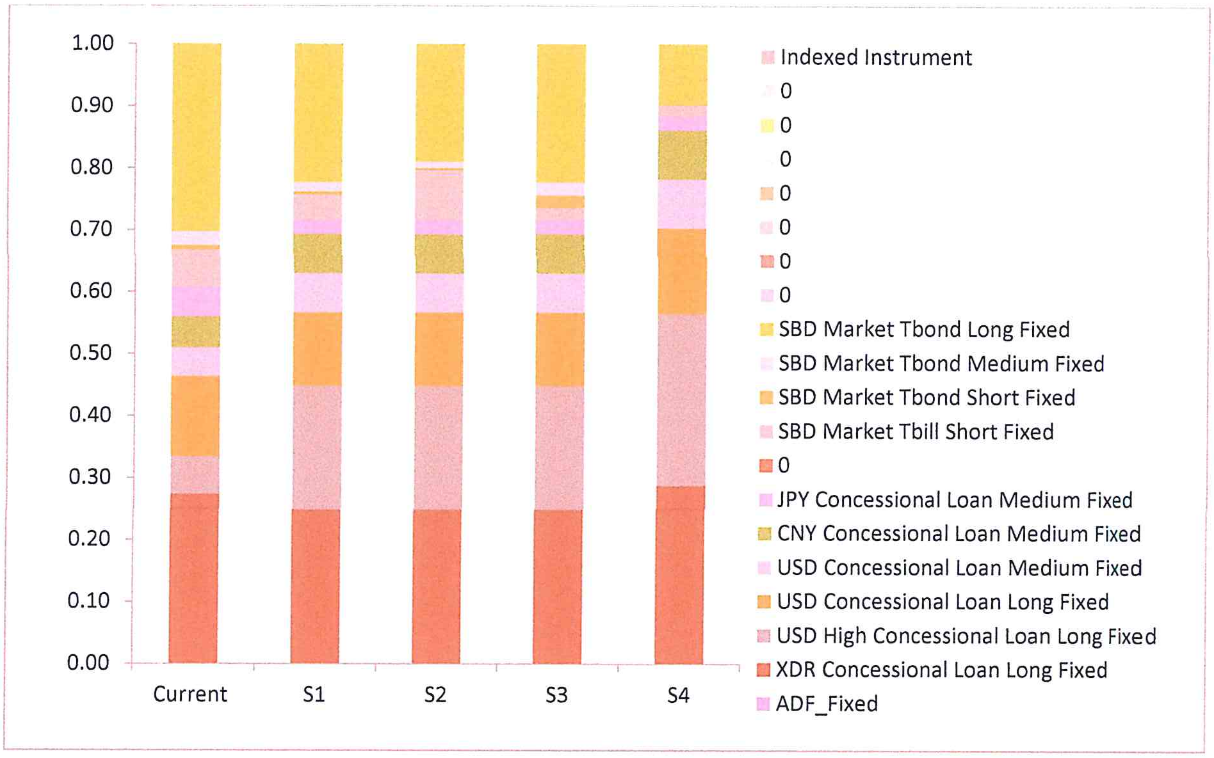
Strategy 4, shows what would the situation be in case the domestic market collapses and most of the financing needs to be secured from external sources.

Figure 1: Financing instruments for each Strategy over the period.



26.0 Figure 2 below illustrates the composition of the financing flows raised from domestic and external sources corresponding to each strategy—expressed as the average annual share of total gross borrowings during the three years of the strategy period. While domestic sources provide financing in local currency, external sources do so in foreign currencies. Strategy 1 and 2 entail a mix of 60/40 between external and domestic financing, in line with historical patterns. On the contrary, strategy 4 relies slightly more on external financing—with an 80/20 mix—while strategy 3 is considerably more dependent on domestic financing—with a 90/10 mix.

Fig 2 Financing by Currency and Strategy



Cost and Risk of the Alternative Strategies for the Baseline Scenario

27.0 The cost-risk trade-offs of the four alternative strategies are key to informing the selection of an adequate strategy to be adopted by the SIG in the medium term. Table 2 summarizes the main cost and risk indicators corresponding to the public debt portfolio that would be outstanding by FY2027 if: (i) the SIG pursues each of the strategies over the next three years, and

(ii) the baseline scenario materializes as expected.

An analysis of said indicators is presented below

Table 5: Baseline Scenario of 4 Strategies: 2025-2027

COST-RISK INDICATORS - Baseline Scenario

Risk Indicators		2024	As at end 2027			
		Current	S1	S2	S3	S4
Nominal debt as percent of GDP		24.02	31.29	31.25	31.30	31.11
Present value debt as percent of GDP		18.15	21.18	21.16	21.18	18.22
Interest payment as percent of GDP		0.51	0.54	0.51	0.54	0.38
Implied interest rate (percent)		2.14	1.89	1.75	1.91	1.13
Refinancing risk2	Debt maturing in 1yr (percent of total)	12.67	10.12	13.80	8.72	6.36
	Debt maturing in 1yr (% of GDP)	3.10	3.17	4.31	2.73	1.98
	ATM External Portfolio (years)	14.53	16.94	16.93	16.94	17.80
	ATM Domestic Portfolio (years)	2.71	1.98	1.71	2.04	1.70
	ATM Total Portfolio (years)	9.98	12.69	12.60	12.71	15.93
Interest rate risk2	ATR (years)	9.98	12.69	12.60	12.71	15.93
	Debt refixing in 1yr (percent of total)	12.67	10.12	13.80	8.72	6.36
	Fixed rate debt incl T-bills (percent of total)	100.00	100.00	100.00	100.00	100.00
	T-bills (percent of total)	5.88	4.08	8.15	1.98	1.83
FX risk	FX debt as % of total	60.78	71.62	71.59	71.63	88.39
	ST FX debt as % of reserves	0.9				

Cost Indicators

28.0 **Debt Stock (as percent of GDP):** The ratio of debt to GDP at the end of the strategy period (i.e., end of FY2027) is projected to increase to 31 percent of GDP from 24 percent earmarked for FY2024 under the four strategies, mainly driven by contraction and disbursement of new loans due to budget deficits.

29.0 **Present Value (PV) of Debt Stock (as percent of GDP):** The Present Value (PV) of Debt Stock at the end of FY 2024 is estimated at 18 percent of GDP. This indicator is forecast to be unchanged for all 4 Strategies.

Interest Payments (as percent of GDP): Interest payments are 0.50 percent of GDP for existing debt and the first 3 Strategies, while it drops for S4 to 0.38 percent.

Risk Indicators

30.0 **Debt maturing in 1-year (as a percentage of total debt)**: At the end of FY 2024, debt maturing in 1-year was 12.67 percent of the total debt and 3.1 percent of GDP. While most strategies improve this indicator, the worst performer is strategy 2, for which it increased to 13.8 percent of total debt and 4.3 percent of GDP, due to a higher issuance of T-bills. The best performing strategy is 4, with debt maturing in 1-year falling to 6.36 percent of total debt and 1.9 percent of GDP, mainly explained by the reduction of outstanding T-bills and the extreme reliance on concessionary offshore borrowing especially from multilateral sources.

31.0 **Average Time to Maturity (ATM, in years):** The average maturity period of existing debt at the end of FY 2024 was 9.98 years, with 14.53 years for external debt, and 2.71 years for domestic debt. During the strategy period, instruments with longer maturity are preferred over shorter tenures for strategies 2, 3 and 4. As a result, the ATM is projected to increase in these strategies, reaching 12.69 years in strategy one, 12.6 years with strategy 2, and 12.71 and 15.93 years with strategy 3 and 4 respectively.

32.0 **T-bills Stock (as percentage of total debt):** Treasury bills represent a minor portion of total debt (only 5.88 percent) issued for short-term cash management purposes. These instruments are expected to reduce their share of total debt in all strategies except in strategy 2, with the largest reduction projected for strategy 4 falling to 1.8 percent of the debt stock. The reason for this higher drop responds to T-bills stock being reduced in nominal terms in Strategy 4, while they are kept constant in all other strategies.

33.0 **External Debt (as percentage of total debt):** External debt represented a little less than two thirds of the total existing debt (60.7 percent) by the end of FY 2024. This share is projected to increase to 88 percent for strategy 4, and unchanged at 71 percent for Strategies 1 to 3.

Analysis of Results: Cost and Risk of the Alternative Strategies for Risk Scenarios

34.0 Complementing the baseline scenario, built upon the macroeconomic framework and pricing assumptions presented, an analysis of shock scenarios is conducted. These scenarios are formulated with shocks to exchange rates and interest rates that may hit the SI economy. There are four shock scenarios being analyzed:

The shocks to the baseline interest and exchange rate projections are detailed below:

1. Risk scenario with large shock to exchange rates: To assess the effect of a devaluation of the SBD against foreign currencies (USD, EUR, CNY and JPY), a 30 percent shock to the exchange rate is introduced in the first year of projection.

2. Risk scenario with moderate shock to interest rates: To evaluate the impact of tightening conditions in domestic financial markets, a 150-basis-point increase in coupon rates of domestic securities issued is introduced all throughout the projection period.

3. Risk scenario with extreme shock to interest rates: To evaluate the impact of extreme tightening conditions in domestic financial markets, a 300-basis-point increase in coupon rates of domestic securities issued is introduced all throughout the projection period.

4. Risk scenario with combined shocks to exchange rates and interest rates: To evaluate the impact of both currency depreciation and tightening conditions in domestic financial markets, a 15 percent shock to the exchange rate is introduced in the first year, and a 150-basis-point increase in coupon rates of domestic securities issued is considered all throughout the projection period.

35.0 **Summary of cost Indicators:** Figures 3 and 4 summarize a key cost indicator which is the Interest Payments (as percent of GDP) for the public debt portfolio that would be outstanding by FY2027 if: (i) the SIG pursues each of the strategies over the next three years, (ii) either baseline or risk scenarios materialize. Figure 3 exhibits the value of said indicator for each strategy and scenario. Borrowing costs are minimized with strategy 1, 2 and 4 (where interest payments are about 3.6 percent of GDP by FY2027) and maximized with strategy 3 (interest payment are about 3.7 percent of GDP). ***Notably, shocks impact all strategies similarly, with the large interest-rate shock triggering the strongest deterioration in the cost indicator.***

Figure 3: Interest to GDP for Different Strategies and Scenarios

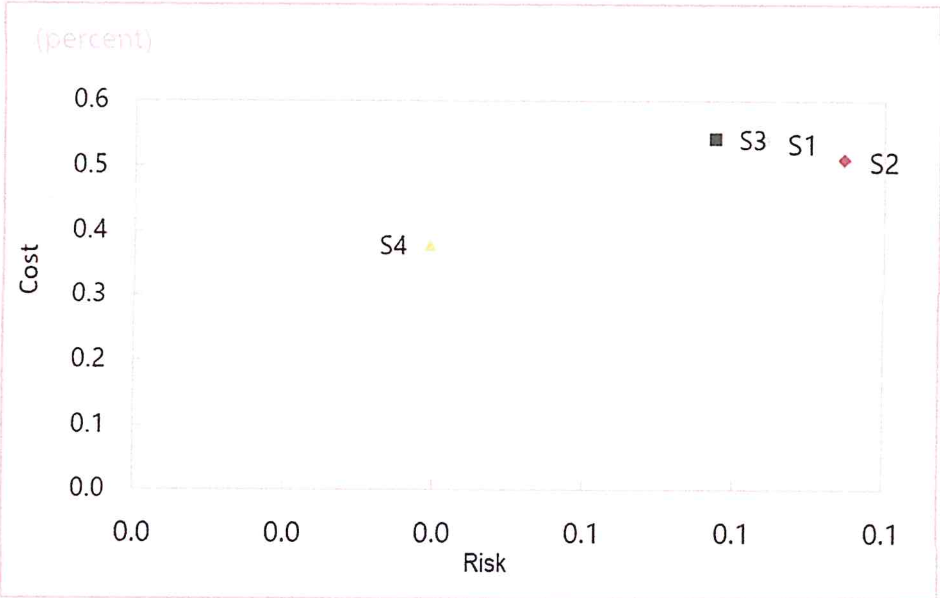
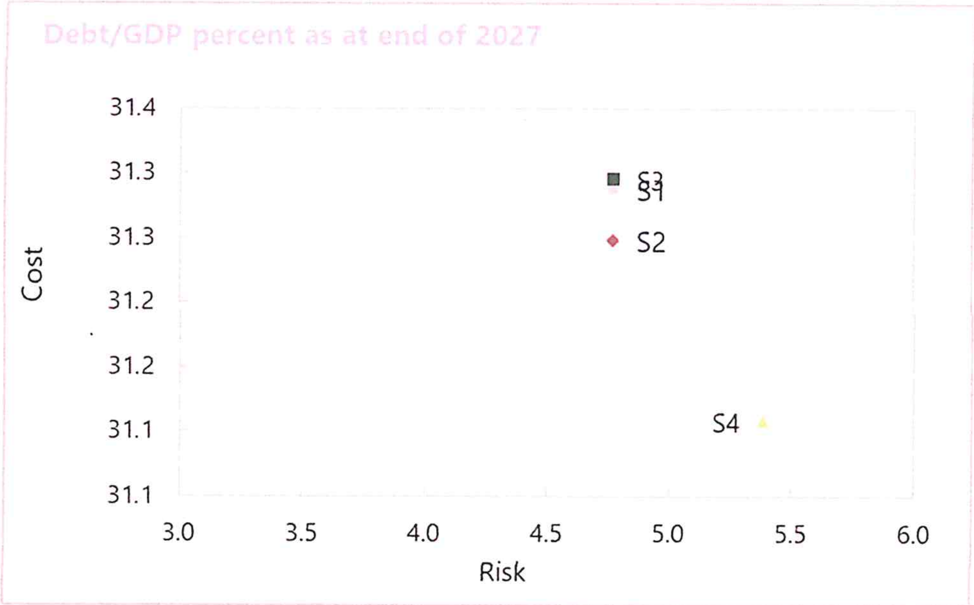


Figure 4 exhibits another key cost indicator—the Debt Stock (as percent of GDP)—for the public debt portfolio that would be outstanding by FY2027 for each strategy and scenario. The expected debt ratio trajectory is fairly similar across the four strategies in the baseline scenario, with the decreasing trend driven by macroeconomic and fiscal variables—not by the debt management strategies themselves.

Figure 4 Debt/GDP Ratio for Different Strategies and Scenarios



Selection of Financing Strategy for Implementation

36.0 As per the assessment of the four borrowing strategies in relation to their consistency with the expected supply of financing from lenders and market investors in the next few years, compliance with policy ceilings and targets, and cost-risk profile, Strategy 1 is selected as the optimal financing path to be adopted by the SIG in the medium term.

S1 would boost development of primary market with Government maintaining a consistent presence in the market. The selected strategy targets an appropriate mix between foreign (60%) and domestic (40%) borrowing through the strategy period.

37.0 Market investors' appetite for Government securities is key to determine the feasibility of securing the financing flows required by any given strategy. Strategy 1 envisages disbursements by external creditors that replicate the pattern observed in the last decade, thus providing a more realistic outlook compared to the other three strategies. The external creditors have strong commitment towards SI and they are willing to provide sizable credit facilities mix with a high degree of grant component; however, the actual disbursements will be largely based on the progress of the projects they finance.

38.0 Compliance with policy ceilings and/or targets on debt stocks, financing flows, or other variables, is another requirement that any strategy must accommodate. Strategy 2 and 3 complies relatively better with the debt management objectives and goals set by the SIG, compared to the other two strategies. Strategy 1 does rely on realistic volumes of concessional financing, especially from multilateral partners which generally offer better credit terms. Government must implement an aggressive external resource mobilization campaign

Strategy 3 also takes into account market preferences. Considering the volatile liquidity and interest rates, market participants prefer to allocate a portion of their investments in short to medium-term instruments. This should support the development of the yield curve, reduce refinancing risk and diversify the investor base for Government bonds. The government will continue to pursue private place arrangements with local institutional investors, with conditions suitable for their appetite.

39.0 Adequate cost-risk profile of any given strategy is also desirable to strengthen public finances in the baseline outlook as well as in the risk scenarios. Strategy 1 offers the preferable outcomes for the SIG. The cost-risk analysis of selected strategy 1 has the following outputs as of the end of strategy period FY2027 in baseline scenario: nominal debt as percent of GDP will reach 31.2 percent while present value of debt as percent of GDP will reach 21.1 percent; Interest payment as percent of GDP will be 0.5 percent with implied interest rate reaching 1.8 percent; debt maturing in l-year will reach 10 percent of total debt and 3.1 percent of GDP; average time to maturity will reach 12.6 years for total portfolio with 16.9 years for external and 1,9 years for domestic; T-bills will come down to 0.9 percent of total while, average time to relaxing will reach 12.6 years and, 10.5 percent of total GDP will need to be relaxed in 1- year; 71.6 percent of total debt will be foreign exchange denominated debt

40.0 To fulfil meeting the Government's financing needs at minimal cost within a prudent level of risk, and to gradually transition towards exploring innovative financing avenues, Government intends to maintain some of the previously set targets. Specifically, regarding Debt to GDP ratio cap at 35 percent threshold. The total interest payments to no more than 3.49% of GDP and the total implied interest rate is targeted to be below 3% by the conclusion of FY 2027.

41.0 Regarding interest rate risk, the Government intends to maintain fixed-rate debt, including Treasury bills, at no less than 80% of the total debt portfolio. This is currently at 100%, SIG intends to issue bonds and T-bills at current yield and to be a price taker. Government aims to restrict the proportion of external and domestic debt of total debt maturing within one year to no more than 6% and 25%, respectively. The total proportion of debt maturing within one year is planned to be capped at 15% of the total outstanding debt.

Implementation of Strategy 1 requires, however, increased efforts by Government to continue improving domestic debt market. Specific efforts are included in the section below.

Development of Domestic Debt Market

42.0 To increase the capacity and reduce the cost of borrowing domestically, the debt strategy aims to facilitate the development of the domestic debt market. From S1 to S4, SIG will be issuing T-Bills and Development bonds to support implementation of developmental projects.

Developing domestic debt markets is a complex process that requires multiple and interdependent policy actions. Issuing debt instrument in the local capital market can be a daunting task because it requires actions from a broad range of stakeholders, including the debt manager; the central bank; regulators; the providers of trading, payment, clearing, and settlement systems; and other policymakers. MOFT is aware further development of SI local bond and t-bill market is relevant and must be country-specific and customized approach to ensure over-subscription. Section VII highlights some of reform action SIG will pursue in the medium term.

The Government will work with the relevant stakeholders to progress the key recommendations over the medium term.

Key initiatives to be undertaken over the medium term includes:

a. Work closely with Institutional Investors (T-Bills and Bonds) and private individuals to ensure debt instruments meets their investment structure and they participate in monthly/weekly auctions as and when SIG makes an announcement. Start producing and publishing, at least a quarterly, debt reports.
b. Smoothing out the maturity profile of the domestic debt (Treasury Bills and Bonds) so that the maturity meets the size of the market)

c. Working closely with CBSI in financing Temporary Advance Facility (TAF)
d. Coordinate with Treasury to share monthly cash flow forecasts so that Issuance of Treasury Bills can be used to support cash management demands in a timely manner.
e. Investor communication and engagement. Publish DMO's Issuance Calendar and historical auction results on the CBSI and MoFT website.
f. Review of the Debt Strategy in line with the Medium-Term Fiscal Strategy (MTFS). More analytical work will be done in this review using the MTDS toolkit provided by World Bank and IMF as a guide; and
g. Develop an investors strategy and include a Quarterly investor meeting to improve investor relations and ensure that the DMU is well informed about market participation and in tune with the investors' appetite for domestic debt instruments

Risks to Implementation of the Strategy

43.0 Potential risks to achieving the next 3 years debt management objectives are as follows:

i. Growth in Government expenditure beyond the projections in the macroeconomic framework thus leading to warrants, supplementary budgets and the need for additional borrowing to meet the requirements.

ii. High level of short-term T-bills outstanding that results in squeeze in liquidity position to service them in timely manner

iii. Poor performance of projects arising from delay in completion of necessary delivery processes to enable commencement of projects and thus slow disbursements of loan and or project financing.

iv. Persistent revenue shortfalls thus widening the fiscal deficit and resulting into increased borrowing beyond the macroeconomic framework used in the formulation of this strategy.

v. Failure to adhere to the planned fiscal consolidation path as provides for in the fiscal framework.

vi. Volatility in the markets rates both domestically and globally resulting in the rise of interest rates and thus impacting of the cost of borrowing

V. Annual Borrowing Plan

44.0 The formulation of the Annual Borrowing Plan ensures that Government meets its financing needs at the lowest possible cost with prudent degree of risk. Additionally, it enhances predictability of government borrowing and helps promote development of the domestic market. The FY2025-2027 borrowing plan indicates total projected borrowing and the split between external and domestic sources. It also anticipates the exploration of innovative financing options available in both the domestic and external market such as the SIG development bonds issued over the medium term and the Treasury bills.

45.0 The PFM Act states that "The Minister of Finance: (i)has sole power to enter into Government borrowing on behalf of the Government; and (ii)is required to provide consent to provincial governments, SOEs and the Honiara City Council for any Government borrowing they intend to undertake. The PFMA requires the Minister to consult the DMAC before exercising power to authorize, or provide consent for, Government borrowing.

Table 6: Annual Borrowing 2025-2027

2025-2027 Annual Borrowing Plan, Authorised and In-Pipeline for DMAC Consideration

Borrowing Proposals	End 2024 Undisbursed Balance (SBD) - Est	2025 ABL SBD($m)	2026 ABL SBD ($m)	2027 ABL SBD ($m)	End 2027 Undisbursed Balances
SIG Direct Borrowing - ABL		**900.00**	**920.00**	**940.00**	
A. DMAC Approved & Pipeline Loan Funded Projects					
External Loans					
ADB Senior Secondary Edu Project (US$10m)	83.6	3.7	8.6	7.8	63.5
ADB Solar Power Project SPEEI (US10m)	83.6	7.5	6.7	8.4	61.0
ADB UWSSSP1 (US$28m)	214.05	8.8	11.3	23.5	170.5
ADB Integrated Solid Waste Project (US$6.93m)	57.9	4.6	11.6	24.8	16.9
ADB Policy Based Loan Subprogram 2 (US$30m)	0.0	0.0	0.0	0.0	0.0
ADB Policy Based Loan Subprogram 3 (US$10m) - New	83.6	0.0	72.4	0.0	11.2
ADB Tina River Hydro Power Project (US$18m)	150.5	56.3	72.4	14.0	7.8
ADFD Tina River Hydro Power Project (US$15m)	125.4	21.1	28.5	42.5	33.3
EDCF Tina River Hydro Power Project (US$31.6m)	209.0	20.5	65.3	76.3	46.9
Exim China PRC SINBIP (CNY 449.8m)	353.7	105.0	74.0	86.0	88.7
GCF Tina River Hydro Power Project (US$70m)	370.4	94.0	113.0	130.2	33.2
IFAD AIM Project (US$9.62m)	80.43	3.7	6.8	8.8	61.1
IFAD Performance Based Loan (USD 7.5m)	19.2	4.3	5.3	1.0	8.6
IDA UWSSSP I (US$15m)	94.48	2.0	8.2	12.5	71.8
IDA UWSSSP II (US$13m)	108.7	13.5	16.4	15.7	63.1
IDA CAUSE II (US$13.2m)	110.37	6.8	11.3	14.5	77.8
IDA SIRAP II (US$48.97m)	215.64	9.8	10.7	15.4	179.7
IDA SIRAP III (US$20m) - New	208.33	4.8	8.6	21.4	173.5
IDA Tina River Hydro Power Project (US$21.3m)	98.66	35.0	42.0	21.6	0.0
World Bank SIART - (US$4.4m)	25.75	4.5	9.5	10.0	1.8
WB Integrated Eco Development and Resilience (US$4.4m)	22.99	3.3	6.8	4.0	8.9
SFD Rural Electrication Project (USD $10m) - New	83.61	3.0	5.3	4.5	70.8
Total External Loans	**2,424.43**	**412.10**	**594.70**	**542.96**	**874.67**
Domestic Borrowing					
SIG Development Bonds (Development projects)	300	300.0	300.0	300.0	*0*
WBG Sovereign guarantee -PPG (US$20m) - New	167	167.0	-	-	*0*
Total Domestic Borrowing	**467.0**	**467.0**	**300.0**	**300.0**	***0***
TOTAL SIG DIRECT BORROWING (EXTERNAL + DOMESTIC)	**2,891.43**	**879.10**	**894.70**	**842.96**	**-**
B. Government guarantee Proposals/On-Lend	**729.17**	**21.7**	**21.74**	**69.1**	
SICC Submarine Cable (US$22.4m)	187.5	16.3	12.4	45.2	**113.60**
Tina Hydro (additional - US$65m)	541.67	5.4	9.3	23.9	**503.03**
C. Pipelines	**1723.9**	**0.0**	**33.6**	**78.0**	**1,612.30**
Bina Harbor Project (US$200m)	1,665.6	0.0	0.0	25.00	1,640.6
Pacific Clean Energy - Solar Power (US$7m)	58.3	0.0	3.60	3.00	51.7
Henderson Airport Runaway Extension (US$40m)	315.0	0.0	10.00	20.00	285.0
DALA Rd, Malaita (AUD70m)	375.0	0.0	20.0	30.0	325.0
ABL Baseline [Total SIG Borrowing = A+B+C]		**900.80**	**950.04**	**990.06**	
Project Debt Servicing (Principal only)		-250.49	-186.65	-204.56	
Net Government Borrowing		**650.31**	**763.39**	**785.50**	
Balanced Annual Borrowing Limit (Amount Available)		250.49	186.65	204.56	0.00

46.0 Based on the current macroeconomic projections for the Fiscal Year 2025-27 projections, the total gross financing requirement is estimated at SBD $900 million for FY2025, $920 million for FY2026 and $940 million for FY2027. This ceiling is intended to be secured through a combination of domestic and external funding sources. Out of the SBD $900 million (USD$112 million) for financing in FY2025, 40% amounting to $300 million, is proposed to be acquired from the domestic market, while the remaining 60%, equivalent to SBD $578 million, will be sourced from abroad.

Treasury bills will be raised from time to time to address any liquidity constraints while Developmental bonds will averaging $300 million on annual basis will be raised in the local capital market. These numbers are tentative and will be revised on annual basis to be consistent with Medium Term Fiscal framework.

47.0 ***Domestic Issuance:*** SIG plans to issue $300 million worth of medium to long-term Bonds for the next 3 years. The maturities of these bonds range from 2 years to 15 years with coupon rates to be determined by demand from investors. Planned floatation by SIG is detailed below:

- Floatation Frequency: Monthly floatation of SBD$50m
- First Month of Auction: May 2025
- Last month of Auction: November 2025
- Maturities (years): 2,3,5,7,10 and 15 years
- Bond yields: Range between 2.5% (2yrs) and 7% (15 yrs)
- Use of Funds: Financing of developmental projects earmarked in 2025 budget

External Loan Drawdown

The pipelines and ongoing projects that have been earmark for FY2025 comprise of:

- World Bank Sovereign Guarantee Loan (US$30m) – the local currency bond backed by WB will be raised towards the 2nd half of 2025. The guarantee by the World Bank will reinvigorate the local bond market and may trigger rise in demand of bond as its issued at commercial rates.
- Budget Policy Loan from World Bank – SIG anticipates the Bank to provide US$10 million loan for budget support.
- Tina Hydro Power Project – the 15-Megawatt power project has made considerable progress in 2024 and we expect drawdown to be around >$100 million for FY2025. To support power demand in Honiara, SIG will commence drawdown of Rural electrification projects that are funded by ADB (US$10m) and Saudi Fund for Development (US$10m). These two loans will be effective in March 2025.
- Ongoing projects – the lists of projects in Table 6 have been approved by DMAC in 2024 and previous years, but no drawdown yet. SIG anticipates most of these projects to roll out effectively in Q1 and throughout the year. As common for all bilateral and multilateral projects, drawdown will depend on implementation on the ground

VI. Policy recommendations for successful implementation of FY2025-2027 MTDS.

48.0 The difficulties posed by appreciation in exchange rates of USD and XDR and interest rate risks have persisted over the decade, despite the formulation of the MTDS. To ensure successful implementation of this strategy, the following steps will be critical:

a) Undertake borrowing within the underlying macroeconomic assumptions in alignment to the proposed debt management strategy.

b) Pursue implementation of the Public Investment Steering Committee by ensuring alignment of prioritized Government program and projects to suitable sources of financing. In addition, exploration of alternative affordable sources of financing to meet the budgetary requirements.

c) DMU to review the MTDS consistent with the Medium-Term Fiscal Projections formulated by Budget Division; to ensure consistency in the underlying assumptions to support sustainable Growth in economy and minimizing costs of debt servicing.

VII. Future Capacity Building Requirements and Strategies to Develop the SI Capital Market

49.0 DMU has been collaborating with PFTAC, World Bank and ADB over the years to improve debt management and establish a robust and transparent local bond market where investors and issuers can work cordially to fulfill each other requirements. Tabulated below are areas of development that would require relevant stakeholders to work together, driven by MOFT and CBSI.

Table 8: Strategies to Develop Local Financial Market

Area	Department	Timing	Lead agency
Institutional			
Institutionalize DMU structure along FO/MO/BO lines and develop procedures to define accountabilities	DMU	Medium Term	MOFT
Business process guiding DMU tasks	DMU	Short-tem	DMU
Improving coordination Between Budget, Treasury and DMU	Ministry	Immediate	DMU
Technical			
Key Principles of Sound Public Debt Management	MOFT	Short-Term	MOFT
The Loan Cycle and Structure of a Loan Agreement	MOFT	Medium Term	
Understanding bond characteristics.	ALL	Short-term	CBSI/DMU
Sources of finance • Borrowing in external markets • Borrowing in domestic markets Types of financial instruments	MOFT/CBSI		MOFT/CBSI
Assessing financial terms for external sources of financing	MOFT	Short-term	MOFT/CBSI
Designing a debt management strategy	MOFT	Immediate	MOFT
Debt Data Base			
Inputting loan and bonds characteristics into Meridian	MOFT/CBSI	Immediate	MOFT/CBSI

Identify data needs from different institutions and design corresponding output tables	CBSI	Medium Term	CBSI
Crosschecking and validating debt data	MOFT	Immediate	DMU
Local Currency Bond Market			
Develop and implement an investor's relations strategy	MoF and CBSI		CBSI
Develop dedicated portal on MoFT website for debt management	MoFT		MOFT/CBSI
Prepare and publish an Issuance Calendar	MOFT	Ongoing	MOFT
Reporting			
Key Reports in Public Debt Management • Key reports for internal use • Key reports for external stakeholders	MoFT	Ongoing	MOFT

For further information, please contact Actg Director Debt Management Unit at the Ministry of Finance & Treasury.

Debt Management Unit
Ministry of Finance & Treasury
Honiara, Solomon Islands

Appendix 1: MTDS Methodology and Timeline

MTDS Formulation Methodology

The review method to be undertaken by DMU include the following:

- **Case Study review –** this is based on similar countries context, study how their debt governance framework is designed, monitored and implemented
- **Consultation with Partners –** this includes PFTAC, ADB and other agencies which promotes debt sustainability and debt reform programs
- **Consultations with Government Departments and SOE –** DMU will also consult relevant stakeholders within Government and those outside to better designed a Strategy that will collaboration and development for the betterment of SI

Proposed Timeline for review of the MTDS

A tentative timeline of the review is tabulated below, the schedule may change depending on availability of personnel.

Activity	Schedule	Time/Venue
Consultations with various Department & Institutions	15 September – 15 October 2024	
Consultations schedule		
• Fiscal/ERU/Climate Change/Budget	15 September 2024	[Venue: Level 3rd Floor, MoFT]
• Treasury/FMSS	18 September 2024	
• PFTAC	19 September 2024	
• CBSI	19 September 2024	[Venue: CBSI]
• Consultations with various selected SOE – DBSI/SINPF/SIPA	19 Sept – 22 September 2024	
Consolidation of findings and drafting of DMF	DMU	
Consultation with PSF	2 November 2024	
Meet with Minister	3 November 2024	
Finalize Final Draft and Submit to Cabinet	10 November 2024	