

II ECONOMIC DEVELOPMENTS DURING THE SECOND QUARTER OF 2004

1. OVERVIEW

The global upswing in economic growth, which has maintained its momentum since the early part of the year has become increasingly broad based. This has been highlighted by the US recovery, which is firmly established, with business investment contributing strongly to the expansion along with consumer demand. With healthy employment growth over recent months, initial concerns about a jobless recovery have faded. Core inflation in the US remains relatively low but has picked up since the start of the year, so that earlier concerns about the risk of deflation have also moved off the agenda. Other parts of the global economy are also enjoying strong or improving conditions. The most notable improvement is in Japan where the economy is enjoying its strongest growth for a decade. The New Zealand economy also continues to grow strongly. The strength of the economy has contributed to tight labour market conditions, with the unemployment rate currently at an historic low. Across the Tasman, the Australian economy is continuing to expand at a good pace. Consumer confidence is at its highest level in a decade and consumer spending has started to receive a significant boost from the additional benefit payments and tax cuts announced in the Federal Budget. In Europe, the United Kingdom is in its twelve years of economic expansion and growing strongly. The recovery in the euro area has been much less pronounced than elsewhere, though conditions are improving.

On the domestic front, the available macroeconomic indicators suggest that economic activity slowed down further in the second quarter of 2004. The adverse impact of Cyclone Heta continued to be evident in most sectors of the economy, in particular the agricultural sector as the supply of produce to the Fugalei Market plunged further. Industrial production also declined for the second consecutive quarter while construction activity increased as bank credit channeled to building and construction activity rose strongly. Imports rebounded faster than exports during the quarter and as a result the merchandise trade deficit widened significantly. Tourism earnings picked up whereas the inflow of private remittances tumbled. In the event, there

was a notable net outflow of foreign funds as the balance of payments closed the quarter with a historically large overall deficit. And, the annual rate of inflation accelerated further to 7.9 percent at end June 2004 from 4.0 percent at end March 2004, consequent to the shortage of local food commodities and increased petroleum prices.

The overall volume of agricultural produce tumbled by a further 19 percent in the June quarter 2004 as the supply of most of the selected local produce declined sharply. In particular, the availability of banana plunged 80 percent and those of taamu, taro and coconut fell by 34 percent, 33 percent and 24 percent respectively. As a result of the lower supplies the overall price index for the market soared 13 percent. And, compared with the June quarter last year, the overall volume index was 47 percent lower and the average price level was 64 percent higher.

Industrial production declined further in the second quarter from a seasonal fall in the preceding quarter. The overall volume index decreased 1 percent due mainly to the lower production of beer, soft drinks, concrete blocks and roofing irons. However, when compared to the same quarter of 2003, industrial output was 1 percent higher.

On the external front, exports rebounded strongly by 30 percent in the June 2004 quarter and were more than twofold higher when compared to the same quarter of 2003. Most of the export commodities increased with fresh fish recording a significant 85 percent rebound as a result of a remarkable pick up in its volume despite the decline in its export price. Imports also increased sharply (up 11 percent) and were 8 percent higher than the second quarter of 2003. The higher level of imports in the three months to June 2004 was due entirely to an 18 percent jump in non-petroleum private sector imports, offsetting decreases in petroleum and Government imports. As a result, the merchandise trade deficit widened significantly. This worsening of the trade balance and a decline in the net inflow of private remittances more than outweighed an increase in tourism earnings. Consequently, the current account deficit widened by 24 percent to \$19.7 million. The capital account, on the other hand,

registered a net outflow of \$13.3 million in contrast to a net inflow of \$16.8 million in the previous quarter due to short-term loans to overseas residents. Hence, the balance of payments reversed the \$0.9 million surplus in the March quarter to record a substantial \$33.0 million overall deficit, the largest quarterly deficit in over five years.

But the significant outflow of foreign funds during the quarter reduced substantially the level of net foreign assets to \$172.1 million. Net domestic assets rose to \$211.5 million. Consequently, total money supply (M2) declined 0.7 percent to \$383.6 million. This fall in M2 was reflected in decreases in demand deposits, currency outside banks and foreign currency deposits of residents. On the other hand, the expansion in net domestic assets was attributed almost entirely to a 10 percent rise in credit to the private sector, which was absorbed mainly by the “Professional and business services”, “Building and construction”, “Trade” and “Transport and communication” sectors.

On the inflation front, the average level of consumer prices as reflected in the Consumer Price Index (CPI) rose a further 3.7 percent in the June quarter of 2004, following a 16.2 percent jump in the preceding quarter. The continued increase in the “Food” sub-index, which recorded another 6.6 percent rise was largely responsible for the higher level of the CPI during the quarter under review. Much of the increase in the “Food” group was due to a 10.4 percent surge in the prices of local food items, particularly the agricultural food crops, following the wrath of Cyclone Heta in January 2004. The imported foodstuffs, on the other hand, also registered a 2.7 percent increase. In addition, there were increases in the prices recorded for building materials, fuel and petroleum. Thus, on an annual average basis, the rate of inflation accelerated to 7.9 percent from 4.0 percent at end March 2004.

The underlying CPI, which has now been published for the first time by the Ministry of Finance showed that the permanent trend in prices rose by 1.3 percent during the quarter. This increase was driven by the “Transport and communication” and the “Food” sub-indices.

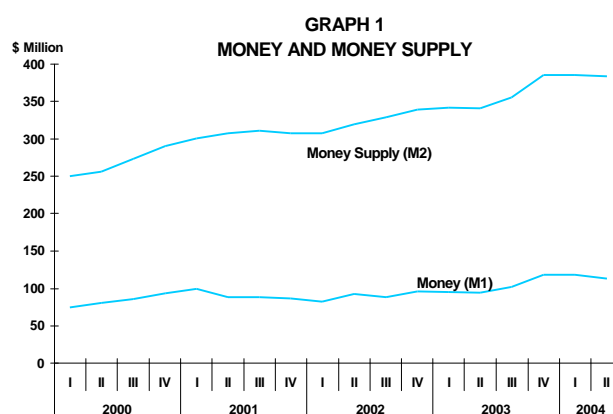
During the quarter under review, the Tala weakened in nominal terms against the Euro and

the US dollar but strengthened against the Fijian dollar, New Zealand dollar and the Australian dollar.

2 MONEY AND CREDIT

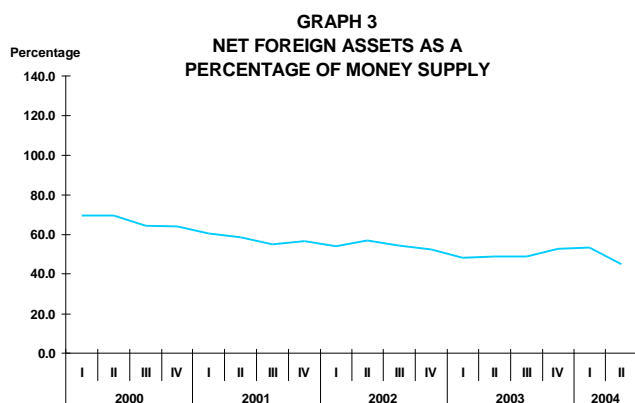
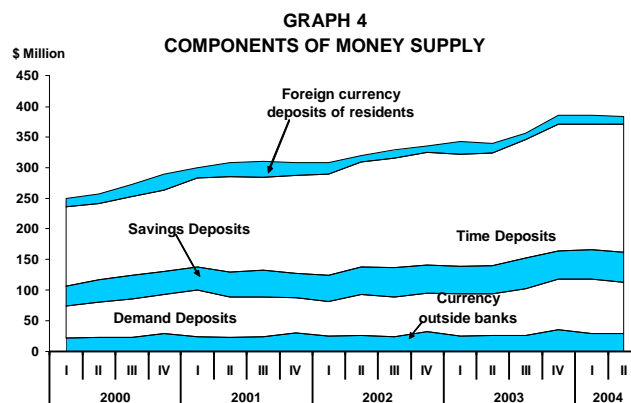
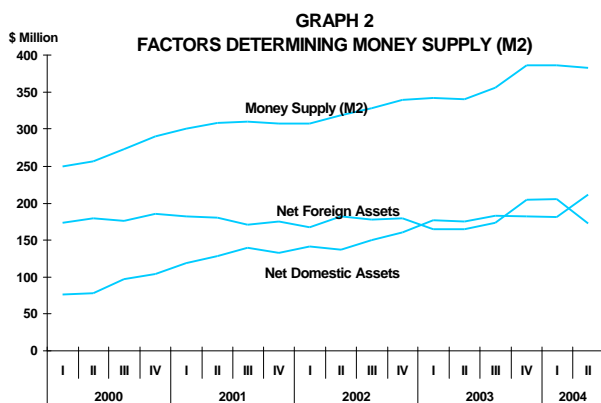
2.1 MONEY SUPPLY

Total money supply (M2) declined \$2.5 million (0.7 percent) to \$383.6 million in the second quarter of 2004, following a slight 0.1 percent decrease in the first quarter. (See Graph 1 and Table A-1.) Nevertheless, in the twelve months to end June 2004, the growth in M2, at 13 percent, was the same as in the period to end March 2004, but was faster than the 7 percent increase in the year to end June 2003. (See Table A-4.)



The contraction of M2 in the quarter under review was caused entirely by a \$33.0 million drop in net foreign assets, which more than offset a \$30.5 million jump in net domestic assets. (See Graph 2 and Table A-2.) This fall in net foreign assets was due largely to a \$29.6 million decline in net foreign reserves held by the commercial banks. In addition, holdings of net foreign assets by the Central Bank and the Ministry of Finance also decreased \$2.2 million and \$1.2 million respectively.

On a yearly basis, however, net foreign assets expanded \$6.7 million to \$172.1 million while net domestic assets surged \$36.5 million to \$211.5 million. As a result, the contribution of net foreign assets to money supply fell to 45 percent at end June 2004 from 49 percent at end June 2003 while that for net domestic assets rose to 55 percent from 51 percent during the same period. (See Graph 3.)



The decline in M2 in the June quarter of 2004 was reflected in decreases in demand deposits (down \$5.5 million), foreign currency deposits of residents (down \$2.4 million) and currency outside banks (down \$0.1 million). These reductions more than offset the increases in time deposits (up \$4.3 million) and savings deposits (up \$1.2 million) during the quarter. In the event, M1 dropped \$5.6 million outweighing a \$3.1 million increase in quasi money.

However, when compared to end June 2003, M1 jumped 20 percent (\$18.8 million) reflecting increases of 25 percent and 9 percent in demand deposits and currency outside banks respectively. Quasi money, as well, went up 10 percent (\$24.4 million) as a result of increases of 13 percent and 9 percent in time deposits and savings deposits in that order, which more than offset a 25 percent drop in foreign currency deposits of residents. (See Graph 4.)

Reflecting the above developments, there were some significant changes in the broad structure of M2 during the second quarter of 2004. The shares of M1 declined to 29 percent from 31 percent while quasi-money rose to 71 percent from 69 percent in the March quarter. (See Table A-5.)

2.2 DEPOSITS WITH COMMERCIAL BANKS

In the June quarter, total deposits with the commercial banks (excluding Central Bank and Government deposits) edged down (0.02 percent) to \$342.9 million following a 2 percent increase in the previous quarter. However, in the year to end June 2004, these deposits rose 15 percent (\$45.0 million), significantly higher than the 5 percent expansion in the same period a year earlier. (See Table A-11 and A-12.)

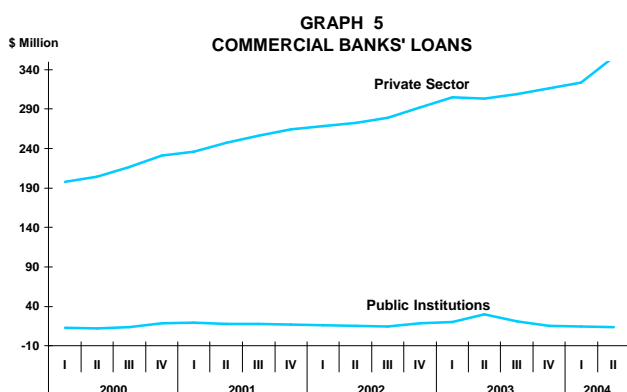
The slight decline in total deposits in the three months to end June 2004 reflected decreases in demand deposits (down \$12.4 million) and time deposits (down \$0.2 million) of the private sector. These more than offset increases in demand deposits and time deposits of public institutions by \$6.9 million and \$4.4 million respectively, as well as a \$1.2 million rise in savings deposits of the private sector. Government deposits dropped \$3.5 million to \$11.5 million in the quarter under review, 51 percent lower than in the twelve months to end June 2004.

2.3 CREDIT

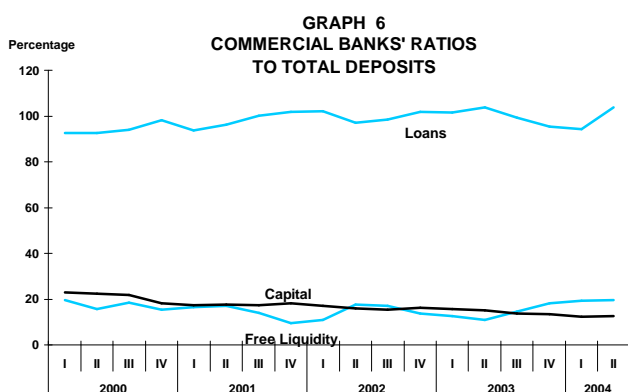
2.3.1. Lending by Commercial Banks

In the second quarter of 2004, commercial bank credit (excluding claims on Government) jumped 9 percent (\$31.6 million) to \$369.5 million. Lending to the private sector, which surged \$32.6 million, was entirely responsible for this substantial growth. Partially offsetting this expansion was a \$1.0 million decline in credit to public institutions, following a \$0.7 million fall in the March quarter. Claims on Government, on the other hand, also dropped \$6.3 million to \$2.1

million during the quarter. (See Graph 5 and Table A-11.)



Over the year to end June 2004, total commercial bank lending (excluding claims on the Government) rose 11 percent (\$35.6 million) but was lower than the 16 percent growth (\$46.1 million) in the period to end June 2003. Lending to the private sector, which jumped 17 percent (\$52.4 million) was entirely responsible for this growth in bank credit, offsetting a 56 percent drop (\$16.8 million) in loans directed to public institutions. (See Graph 6 and Table A-12.)



During the June quarter, commercial banks lending grew at a faster rate than that of deposits. As a result, the loans to deposit ratio rose from 94 percent in the previous quarter to 104 percent in the quarter under review. This significantly higher ratio was made possible by a marked decline in the level of free reserves held by the commercial banks.

2.3.1.1 Sectoral distribution of private sector credit

The bulk of the increase in loans to the private sector in the June quarter was absorbed by the "Professional and business services" (up \$21.4 million or 44 percent), followed by the "Building

and Construction" (up \$5.5 million or 4 percent). Loans directed to "Trade", "Transportation and communication", "Manufacturing" and "Electricity, gas and water" sectors also went up \$2.8 million (4 percent), \$2.5 million (14 percent), \$0.5 million (3 percent) and \$0.1 million (5 percent) in that order. On the other hand, credit channelled to the "Agriculture" and "Other activities" sectors declined \$0.2 million each during the quarter. (See Table A-13.)

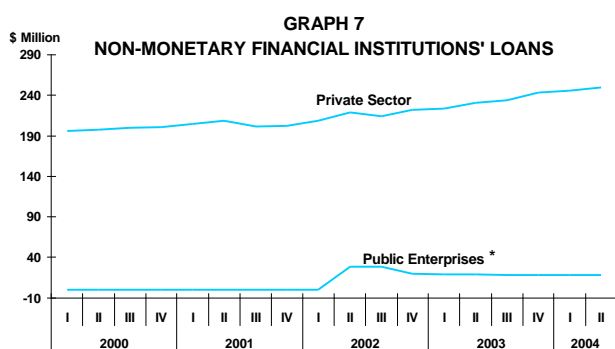
In effect, there were some changes in the distribution pattern of loans outstanding to the private sector in the quarter under review. The "Building and Construction" sector continued to be the largest recipient of bank credit, although its share declined to 38 percent from 40 percent in the previous quarter, followed by the "Trade" sector with its share remaining at 22 percent as was in the March quarter. The share of the "Professional and business services" jumped to 20 percent from 15 percent while "Other activities" sector declined from 9 percent to 8 percent in the quarter under review. The proportions absorbed by "Manufacturing", "Agriculture" and "Electricity", on the other hand, remained the same as in the preceding quarter at 6 percent, 2 percent and 1 percent respectively.

2.3.2 Lending by the non-monetary financial institutions (NFIs)

In the second quarter of 2004, there was a steady expansion in loans granted by the NFIs (excluding claims on Government), increasing by a further 1 percent (\$3.9 million) to \$267.1 million; a level that was 7 percent higher than in the second quarter of 2003. This increase in NFI credit was due exclusively to a \$3.9 million boost in lending to the private sector, more than offsetting a marginal fall in loans to the non-financial public enterprises. Claims on Government, on the other hand, remained unchanged from the previous quarter at \$0.2 million. (See Graph 7 and Table A-16a.)

The entire growth in NFI credit to the private sector during the three months to June 2004 was directed primarily to the "Other Activities" sector (which rose \$3.9 million to \$94.4 million) and the "Trade" sector (up \$0.2 million to \$27.7 million).

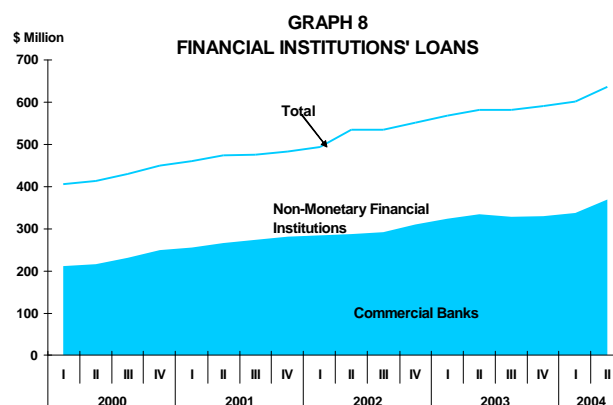
On the other hand, there was a decrease of \$0.1 million (to \$61.8 million) in lending to the “Building and construction” sector as well as smaller decreases of \$10 thousand each to the “Agriculture” (down to \$33.40 million) and “Professional and business services” sectors (down to \$11.15 million). All other sectors, specifically “Manufacturing”, “Electricity, gas and water”, and “Transportation, storage and communication” remained unchanged at \$8.0 million, \$0.1 million and \$12.8 million respectively.



(*) Beginning in June 2002, loans of public enterprises that were previously classified under 'other assets' were reclassified to their appropriate categories. Historical series will be revised when data become available.

As a result, there were minor changes in the broad sectoral distribution of NFI loans to the private sector in the second quarter of 2004. The “Other Activities” sector remained the largest recipient of NFI loans with shares of 38 percent (up 1 percent from the previous quarter), followed by the “Building and construction” sector with 25 percent. The “Agriculture, forestry and fishery” sector had a 13 percent share of the NFI credit to the private sector while the “Trade”, “Transportation, storage and communication”, “Professional and business services” and “Manufacturing” sectors all retained shares of 11 percent, 5 percent, 5 percent and 3 percent in that order.

Total loans provided by the financial system (NFIs and commercial banks) to the private sector and public institutions combined increased another 6 percent (or \$35.5 million) to \$636.6 million in the June 2004 quarter. Accordingly, the proportion of loans provided by the commercial banks rose to 58 percent from 56 percent in the previous quarter whereas the non-monetary financial institutions disbursed 42 percent in the June 2004 quarter compared to 44 percent in the preceding quarter. (See Graph 8.)



2.4 DOMESTIC INTEREST RATES

The continued accommodative monetary policy stance saw interest rates decline further in the second quarter of 2004. Both lending rates and deposit rates, fell 0.15 percentage points to 11.19 percent and 0.07 percentage points to 4.43 percent respectively. As a result, the commercial banks' interest rate spread¹ narrowed to 6.76 percent at end June 2004 from 6.84 percent at end March 2004. On the other hand, the average interest rate on loans offered by the non-monetary financial institutions remained unchanged at 13.0 percent at end June 2004. (See Table A – 15.)

Compared to the second quarter of 2003, both the commercial banks' average lending and deposit rates were lower in the second quarter of 2004, which resulted in a slightly lower interest rate spread in the three months to June 2004 relative to the same period of 2003. For the non-monetary financial institutions, however, the average lending rate in the quarter under review has remained constant at 13.0 percent since the September quarter of 2000.

3. OPEN MARKET OPERATIONS

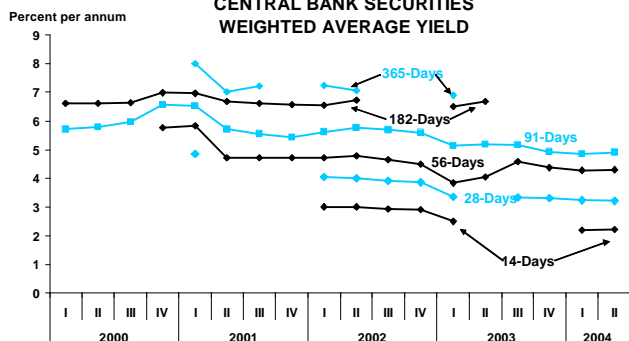
During the June quarter, 11 issues of Central Bank Securities were made which amounted to a combined value of \$82.8 million and was \$11.8 million greater than the previous quarter. A total worth of \$88.2 million in bids was submitted, of which only \$79.8 million was allotted to the

¹ Footnote: the weighted interest rate spread is the difference between the interest rates on private sector deposits and private sector credit. Taken on its own, it does not accurately reflect the profitability of the banking system since it does not take into account losses due to non-performing loans, regulatory costs and other revenues.

successful bidders. The allotted amount for the June quarter was also \$18.3 million higher than the previous quarter, and this continues to reflect the Central Bank's accommodative monetary policy stance.

There were no rediscounts made during this period, which indicates a high level of liquidity in the system, with some banks relatively more liquid than others.

**GRAPH 9
CENTRAL BANK SECURITIES
WEIGHTED AVERAGE YIELD**

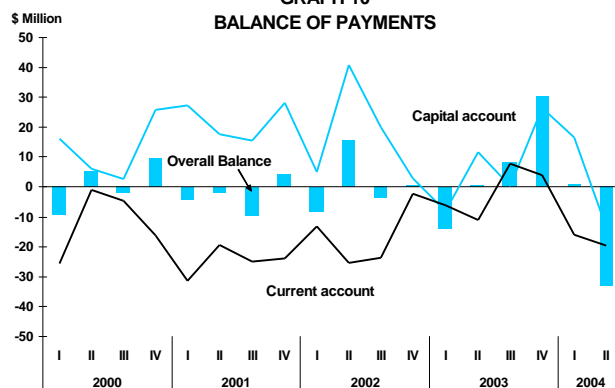


Interest rates on some maturities were more volatile than others in the second quarter of 2004. Interest rates on the 14-day paper undulated between 2.18 and 2.23 percent but had inclined from 2.20 percent to 2.22 percent by the end of the quarter. The 28-day paper reflected a similar pattern, with yields oscillating within the 3.19 to 3.25 percent range but rose from 3.20 to 3.21 percent at end June. Interest rates on the 56-day paper deviated within the 4.30 to 4.33 percent range. At one point, it had dropped to 4.21 percent but it later inclined to a steady 4.30 percent by end June. The yield on the bench mark 91-day bill rose from 4.88 percent to 4.90 percent. No issues were made for the longer-term securities (182 and 365 days) so their yields remain unchanged at 6.50 percent and 6.90 percent respectively.

4. BALANCE OF PAYMENTS

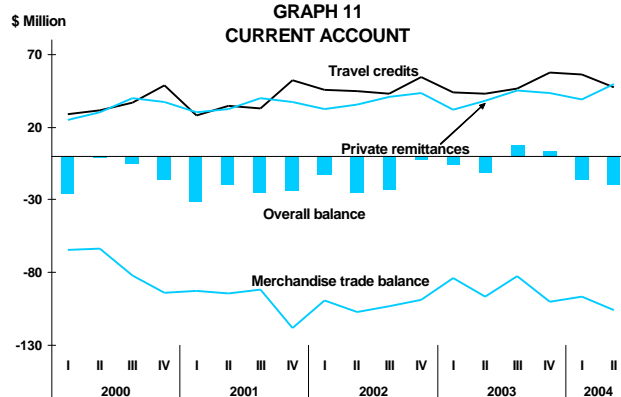
The balance of payments reversed the \$0.9 million overall surplus in the March quarter to register a record overall deficit of \$33.0 million in the second quarter of 2003. This was mainly due to a capital account deficit of \$13.3 million reflecting short tem loans to overseas during the quarter under review. (See Graph 10 and Table B-1.)

**GRAPH 10
BALANCE OF PAYMENTS**

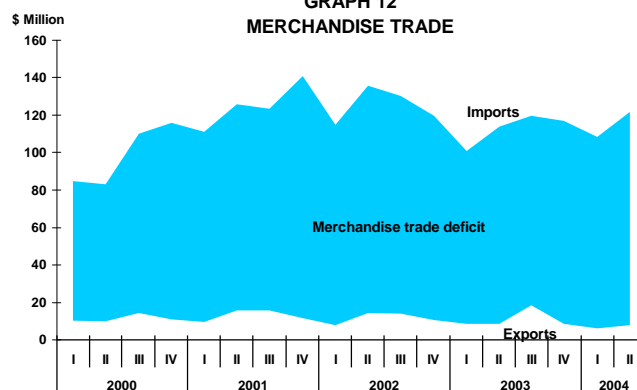


The current account deficit widened 24 percent in the June quarter of 2004 to \$19.7 million, as a result of a notable increase in the merchandise trade deficit, plus a decline in the net inflow of private remittances despite a rise in tourism earnings. (See Graph 11.) The merchandise trade deficit expanded 10 percent (\$9.7 million) as total imports jumped \$11.6 million, more than offsetting a \$1.8 million increase in total exports. (See Graph 12 and Section 5.)

**GRAPH 11
CURRENT ACCOUNT**



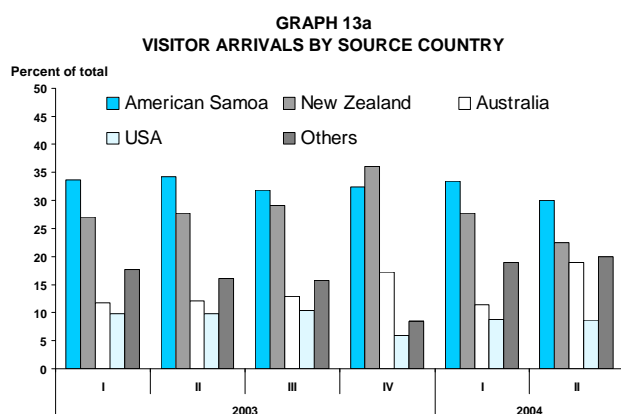
**GRAPH 12
MERCHANDISE TRADE**



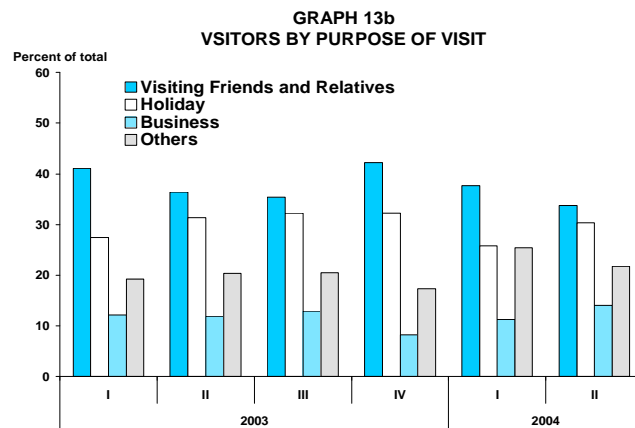
In line with seasonal trends, net inflow of private remittances declined 16 percent (or \$9.0 million) to \$47.2 million in the quarter under review. However, when compared with the June quarter of 2003, the net inflow of private remittances

improved 11 percent reflecting the continued strong growth in the economies of the US, New Zealand and Australia. The inflow of remittances from the US amounted to 50 percent of the total while New Zealand and Australia accounted for 21 percent and 16 percent respectively in the second quarter of 2004. About 52 percent of the total inflows were remittances for Samoan individuals while churches and non-government schools made up 34 percent. (See Table E-7.)

In line with past trends, tourist arrivals increased 22 percent in the quarter under review, following a seasonal fall in the previous quarter. Consequently, tourism earnings climbed 26 percent (up \$10.3 million) to \$49.5 million. At this level, tourism earnings were 30 percent higher than the level in the same period last year. The percentage of visitors from American Samoa fell to 30 percent from 33 percent and that for New Zealand declined to 22 percent from 27 percent in the first quarter of 2004. Visitors from Australia, on the other hand, rose to 19 percent from 11 percent while the USA remained at 9 percent. The number of those visiting friends and relatives fell to 34 percent from 38 percent while those on holiday rose to 30 percent from 26 percent in the previous quarter. Tourists traveling for business and sports, likewise increased to 14 percent and 2 percent from 11 percent and 1 percent respectively. (See Graphs 13a and 13b and Table E-6.)



On the investment income account, there was a net outflow of \$3.5 million due to significant dividend payments made during the June quarter of 2004. Other 'miscellaneous' services recorded a net inflow of \$3.7 million, which was significantly lower than a net outflow of \$12.4 million in the March quarter of 2004.



Significant outflows of private capital saw the overall capital account register a net outflow of \$13.3 million, in contrast to a net inflow of \$16.8 million in the March 2004 quarter. Government transfers remained unchanged at \$17.5 million and Government loans recorded a slightly larger net disbursement of \$5.1 million than the \$5.0 million disbursement in the previous quarter. Private sector capital registered a substantial net outflow of \$31.4 million, compared to a net outflow of \$4.0 million in the March quarter of 2004, due to large overseas loans to foreign companies in American Samoa as well as remittances of proceeds from the sale of real estate properties by owners now residing overseas.

5. FOREIGN TRADE

5.1. EXPORTS

The total value of exports (including re-exports) in the June quarter of 2004 rebounded 30 percent (or \$1.8 million) to \$7.8 million. And, when compared with the same quarter last year, export earnings for the period under review were more than twofold higher. (See Table B-5.)

The strong growth in export revenues in the second quarter of 2004 was mainly due to a vigorous rebound in fresh fish plus increased earnings from nonu juice, taro, nonu fruit, coconuts, coconut cream and beer. Earnings from fresh fish jumped 85 percent (or \$1.4 million) to \$3.1 million as a result of a 95 percent jump in its volume which outweighed a 5 percent decline in its export price. Export proceeds from nonu juice followed with a 27 percent (or \$274 thousand) rise to \$1.3 million reflecting gains of 16 percent and 10 percent respectively in its export volume and international price. Proceeds from taro exports

also leapt 53 percent (or \$249 thousand) to \$716 thousand as a result of increases of 28 percent and 20 percent respectively in its export price and volume. Revenues from nonu fruit followed with 93 percent (or \$184 thousand) to \$382 thousand as a result of a 93 percent hike in its export volume and a 1 percent increase in its price. Smaller gains were recorded in earnings from coconuts (up \$61 thousand), coconut cream (up \$60 thousand) and beer (up \$40 thousand) to \$103 thousand, \$747 thousand and \$1.1 million in that order. On the downside, returns from coconut oil plunged 76 percent (or \$455 thousand) to \$142 thousand as a result of a 71 percent fall in its export volume and an 18 percent drop in its export price. Earnings from soft drinks also fell 16 percent (or \$9 thousand) and there was no export of copra meal in contrast to \$6 thousand earned in the previous quarter.

The Pacific region remained the largest market for our exports although its share declined to 57 percent from 64 percent in the previous quarter. (See Table B-6.) This was mainly due to the fall in Australia's share to 6 percent from 15 percent in the previous quarter following a drop in coconut oil exports to that country. American Samoa continued to take the largest share of exports with its share increasing to 43 percent from 39 percent in the previous quarter. The USA followed with a share of 36 percent, up from 26 percent in the previous quarter as a result of the surge in fish and nonu exports. New Zealand and Japan accounted for 8 percent each of the total exports, down from 10 percent each in the previous quarter.

5.2 IMPORTS

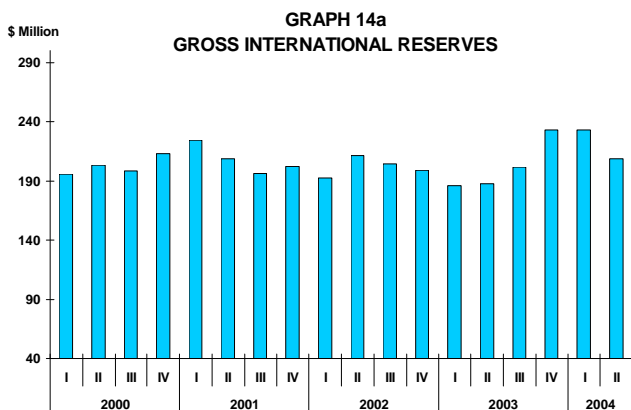
The total value of imports rebounded 11 percent (\$11.6 million) to \$113.8 million in the second quarter of 2004, in contrast to a 6 percent decline in the previous quarter. And, when compared with the same quarter last year, the total value of imports in the June quarter of 2004 was 8 percent higher. The expansion of total imports during the June quarter 2004 was attributed to a substantial increase in non-petroleum private sector imports by 18 percent (or \$15.1 million) to \$97.5 million. This surge in non-petroleum private sector imports outweighed decreases in petroleum and Government imports, down by 17 percent (or \$3.2 million) and 66 percent (or \$303 thousand)

respectively to \$16.1 million and \$156 thousand respectively. (See Table B-2.)

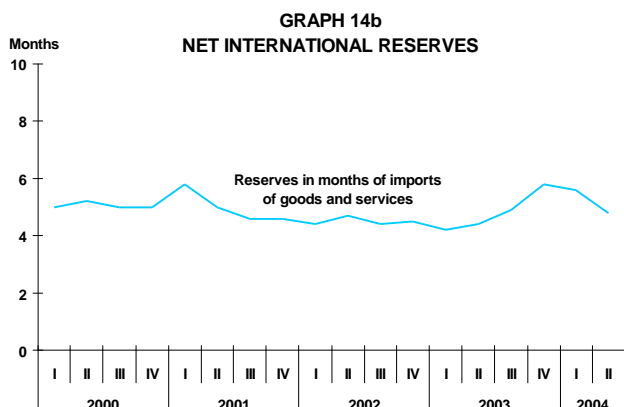
The Pacific region remained the main source of imports for Samoa, despite the drop in its share to 55 percent in the quarter under review from 59 percent in the previous quarter. This fall in its share was attributed to the decline in Australia's share to 15 percent from 18 percent and that of Fiji to 7 percent from 8 percent in the previous quarter. New Zealand continued to hold the largest share at 32 percent (unchanged from the previous quarter) followed by the USA with 12 percent, down from 13 percent in the previous quarter. Singapore contributed 9 percent, down from 14 percent in the previous quarter while Fiji accounted for 7 percent, down from 8 percent. The share of 'Other' Asian countries which included the Philippines surged to 12 percent from 5 percent reflecting a large shipment of petroleum imports in June 2004. The ratio for Japan and China, on the other hand, increased to 5 percent and 3 percent from 4 percent and 2 percent in that order in the previous quarter. The shares of Hong Kong, Germany, American Samoa, Canada, United Kingdom and Taiwan remained very small and virtually unchanged from their shares in the previous quarter. (See Table B-7.)

6. EXTERNAL ASSETS

Samoa's external reserves plunged by a further 10 percent (\$24.2 million) to \$208.6 million in the second quarter of 2004. However, when compared to the second quarter of 2003, the current level of gross reserves was 11 percent higher. On a net basis, (i.e. after subtracting short term foreign liabilities from gross foreign reserves) external reserves dwindled 16 percent (or \$33.0 million) to \$172.1 million, reflecting the overall deficit in the balance of payments in the three months to June 2004. The substantial decline in net foreign assets in the quarter under review saw the import coverage for goods and services fall to 4.0 months from 4.9 months in the previous quarter, and was just above the 3.9 months in the June 2003 quarter. (See Graph 14a and Table B-10.)



As a result, there were major changes in the composition of gross reserves held by the different sectors of the monetary system in the June 2004 quarter. While the shares held by both the Central Bank and the Ministry of Finance (formerly the Treasury) expanded to 67 percent and 25 percent respectively at end June 2004, the ratio of foreign reserves held by the commercial banks almost halved to 8 percent from 17 percent in the preceding quarter. The Central Bank remained the main custodian of the country's foreign exchange reserves.

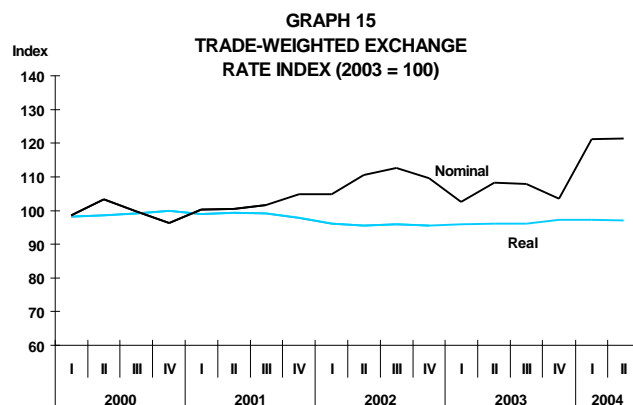


7. EXCHANGE RATES

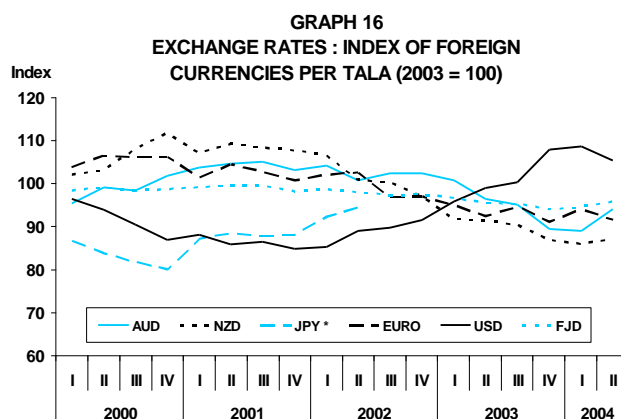
After falling in the previous two years, the US dollar has appreciated against most major currencies from January through to mid May, as greater confidence in the US economic recovery and the increasing likelihood that interest rates would rise supported the currency. However, in mid May, the uptrend in the US dollar stalled and the currency has subsequently lost some ground. This turnaround predominantly reflected the softer than expected data in the US for the month of June, which reduced expectations about the future pace of monetary tightening.

During the June quarter, the Tala depreciated in nominal terms against the Euro (2.44 percent) and the US dollar (3.06 percent), but appreciated against the Fijian dollar (1.22 percent), Australian dollar (5.87 percent) and the New Zealand dollar (1.36 percent).

The nominal effective exchange rate (NEER) index of the Tala decreased by 0.4 percent in the second quarter of 2004, compared to the 0.1 percent increase in the first quarter. (See Graph 15 and Samoa's Key Economic Indicators.)



On an annual average basis, the real effective exchange rate (REER) index rose by 0.23 percent in the year to end June 2004 compared with a 17.2 percent increase in the year to end March 2004. This movement was mainly attributed to the higher rate of inflation in Samoa than its major trading partners.



* New basket effective August 1 2002 excluded the Japanese Yen.

8. INTERNATIONAL INTEREST RATES

Given mounting evidence that the global recovery is now firmly in place, central banks around the world have begun to remove some of their earlier policy stimulus. The US Federal Reserve Bank of

New York (FRBNY), Bank of England (BOE) and the Reserve Bank of New Zealand (RBNZ) have lifted their policy rates in the past three months, while the Reserve Bank of Australia (RBA) and the European Central Bank (ECB) decided to leave their interest rates unchanged.

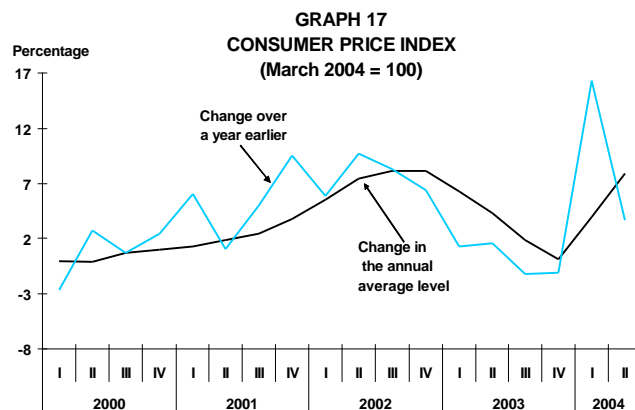
Against the background of the firming US economy, the Federal Reserve had decided in late June to raise interest rate by 25 basis points to 1.25 percent. With US interest rates still well below historical levels, markets expect additional tightening and a further increase in the funds rate over the next six months. The BOE raised its repo rate by 25 basis points in both May and June, to reach 4.5 per cent, and has signaled that it expects to increase rates further over coming months. The RBNZ increased its interest rate by 25 basis points in June to 5.75 percent. With domestic demand continuing to be the key driver of growth in New Zealand, the central bank has indicated that further increases are likely over the coming months to accommodate these domestic price pressures

The RBA and the ECB, on the other hand, maintained their interest rate levels at 5.25 percent and 2.00 percent respectively in the quarter under review. In Australia, market expectations remained steady through this period, with their assessments that Australian rates were closer to normal than in most other countries. In Europe, expectations of further cuts have dissipated in recent months, as the economic news has improved slightly.

9. PRICES

9.1 HEADLINE CPI

The Statistical Services Division of the Ministry of Finance recently revised and rebased its new Consumer Price Index (CPI) from its earlier published index which was presented in the June 2004 Bulletin. This new index showed that the average level of prices increased a further 3.7 percent in the second quarter of 2004, following a 16.2 percent surge in the previous quarter. And, on an annual average basis, the rate of inflation at end June 2004 accelerated further to 7.9 percent from 4.0 percent at end March 2004 and was well above the 4.3 percent rate recorded at end June 2003. (See Graph 17 and Table D-1B)



The increase in the average level of prices in the June quarter of 2004 was due largely to another 6.6 percent increase (after the 27.6 percent surge in the March 2004 quarter) in the “Food” sub-index, which accounts for approximately 50 percent of the CPI. This expansion was caused mainly by a 10.4 percent growth in the overall level of local food prices in the three months to June 2004, as shortages of the main food crops such as taro, banana and taamu, as well as coconut and tomatoes took its toll on the price levels offered at the Fugalei Market. Also adding pressure on food prices was a 2.7 percent rise in imported foodstuffs reflecting higher prices for some imported commodities such as mutton flaps (up 3.5 percent), turkey tails (up 9.7 percent), rice (up 7.2 percent), potatoes (up 5.8 percent) and flour (up 10.0 percent). Further to the higher level of the “Food” sub-group, the “Housing and Household Operations” (which comprises 11 percent of the overall CPI) also rose 0.8 percent in the June 2004 quarter, driven mainly by a 1.9 percent increase in its import component as the demand for imported building materials strengthened on the back of more construction projects around the country. The “Miscellaneous” sub-index (which represents 10 percent of total CPI) also registered a 0.6 rise in the three months to June 2004 after remaining constant in the three months to March 2004. Likewise, the “Transport and Communications” sub-index (that accounts for 14 percent of the overall CPI) edged up 0.4 percent as international oil prices continued to escalate due to increasing worldwide demand, fear and speculation surrounding the Middle East crises and reduced supplies from source countries. On the other hand, there were 1.8 percent and 0.1 percent decreases in the “Clothing and Footwear” and “Alcohol and Tobacco” sub-groups respectively (which make up 2 percent and 12 percent of the total CPI in that order).

With regards to the overall "Import Component" (which impacts directly on most sub-indices of the CPI, contributing 44 percent to the overall CPI), there was a further 2.5 percent expansion following the 1.7 percent rise in the March 2004 quarter, with much of this resulting from higher prices for imported food items.

9.2 UNDERLYING CPI

Apart from the new CPI, the Ministry of Finance also published for the first time an Underlying Index. This underlying index excludes all the prices of those items that are often influenced by temporary supply shocks, which often obscure the long-term movements of inflation. These items include volatile food items (such as agricultural foodstuffs) and Government regulated price items (such as petrol, bus and taxis fares, alcohol and tobacco etc). This index excludes approximately 49 percent of the headline (overall) CPI. (See Table D2.)

In the quarter under review, the underlying index showed that the average level of prices increased a further 1.3 percent, driven mainly by a 1.8 percent boost in the "Transport and Communication" sub-index and a 1.7 percent increase in the "Food" sub-index. The expansion in the "Transport and Communication" sub-index was attributed primarily to a 3.6 percent growth in its import component, reflecting higher prices for imported motor vehicle products and accessories, as well as petroleum. The increase in the "Food" sub-group was also due to its import component, which grew 1.9 percent over the previous quarter, as a result of increasing prices for imported food items such as mutton flaps, turkey tails, flour, rice and potatoes. Both the "Housing and household operations" and "Miscellaneous" sub-groups also registered increases of 0.7 percent and 0.6 percent respectively as a result of 1.2 percent and 0.8 percent rises in that order in their import component. The "Clothing and Footwear" sub-group, on the other hand, recorded a 1.4 percent reduction from the previous quarter, reflecting cheaper imported items from source countries and as a result of increasing competition in the local market.

10. INDUSTRIAL PRODUCTION

In the second quarter of 2004, the overall volume index of selected industrial products fell further by 1 percent following a 3 percent drop in the previous quarter. The contraction in the production of beer, soft drinks and miscellaneous products were largely responsible for this fall. However, when compared with the second quarter of 2003, the overall volume index was slightly 1 percent higher. (See Table E-2.)

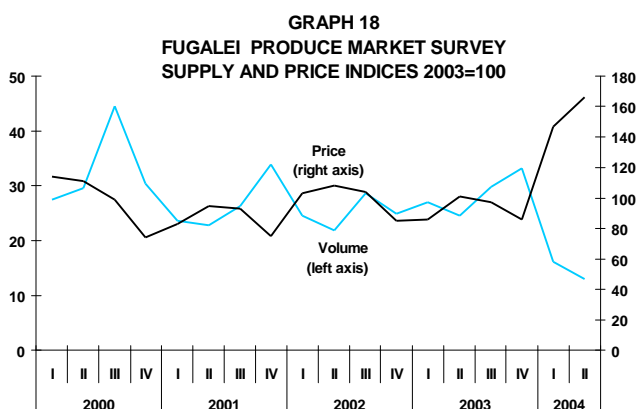
The production of beverages (beer and soft drinks) decreased by a further 5 percent and 10 percent respectively, after declining in the previous quarter. As well, the output of roofing iron and concrete blocks dropped 8 percent and 3 percent in that order. Partially outweighing these reductions, were gains in the production of electricity, cigarettes, timber and coconut cream, which rose 2 percent, 4 percent, 11 percent and 1 percent respectively. The output of miscellaneous products recovered in the June quarter of 2004 by 15 percent and that of ice cream and corned meat rose 26 percent each. In addition, the volume of ready mix cement expanded 5 percent, following a 31 percent jump in the previous quarter while that of paints remained unchanged.

Compared with the June quarter of 2003, the production of beer and soft drinks contracted 3 percent and 2 percent respectively and that of electricity fell 5 percent. Outputs for cigarettes and coconut cream declined 23 percent and 6 percent respectively. In addition, the production of roofing iron dropped 9 percent. On the other hand, the production of building materials, - timber, paints, concrete blocks and ready mix cement - expanded by 24 percent, 19 percent, 30 percent and 47 percent respectively. Likewise, the output of miscellaneous products, corned meat and ice cream increased 19 percent, 13 percent and 62 percent in that order.

As a result of the decrease in the overall volume in the quarter under review, the total value of industrial production rose 2 percent to a level 5 percent higher than in the same quarter of last year. The overall price index was 1 percent and 3 percent higher than the March quarter of 2004 and June quarter of 2003.

11. FUGALEI MARKET SURVEY

The overall volume of selected produce supplied to the Fugalei Market in the June quarter of 2004 decreased 19 percent, following a 52 percent drop in the preceding quarter. The lower supply in the quarter under review was largely due to a sharp decline in the supply of taro, banana, taamu, coconut and tomatoes which more than offset gains in the supply of taro palagi, head cabbage, chinese cabbage, cucumber and pumpkin. When compared with the same quarter of 2003, the overall volume index was likewise, 47 percent lower. (See Graph 18 and Table E-5).



28 percent) coconut (up 38 percent) and tomatoes (up 7 percent). Partially offsetting these higher prices were decreases in the prices of head cabbage, chinese cabbage, cucumber and pumpkin by 37 percent, 16 percent, 17 percent and 11 percent in that order.

When compared with the same quarter of 2003, the overall volume index was 47 percent lower, due largely to significant reductions in the supplies of all commodities except for pumpkin which jumped 54 percent. The volume of taro, taro palagi, banana and taamu shrank 68 percent, 91 percent, 11 percent and 5 percent respectively. Likewise, the availability of coconut, chinese cabbage, head cabbage, tomatoes and cucumber declined 34 percent, 10 percent, 13 percent, 26 percent 28 percent in that order.

Looking ahead to the next three months, the overall volume of selected commodities to the Fugalei Market is expected to recover as agricultural crops replanted following the cyclone are ready for harvest especially taro, banana, taro palagi and most of the vegetables items.

The effects of cyclone Heta continued to see the average supply of taro dwindle 33 percent in the second quarter of 2004 following a significant reduction in the previous quarter. As well, the availability of banana plunged 80 percent as its supply was virtually depleted while that of taamu and coconut decreased 34 percent and 24 percent respectively. The availability of tomatoes declined 19 percent following a substantial drop in the previous quarter. On the other hand, the supply of taro palagi more than tripled in the June quarter of 2004 while that of head cabbage surged 81 percent. The average supply of chinese cabbage leapt 77 percent and that of cucumber soared 87 percent. The volume of pumpkin sold at the Market also increased 3 percent. The availability of breadfruit recovered strongly in the quarter under review while that of yam dropped 41 percent (substitute items which are not yet included in the survey indices).

As a result of the lower level of supplies in the second quarter of 2004, the average price level at the Fugalei Market climbed 13 percent, reflecting higher prices of taro, (up 37 percent) banana, (up 11 percent) taro palagi, (up 55 percent) taamu, (up