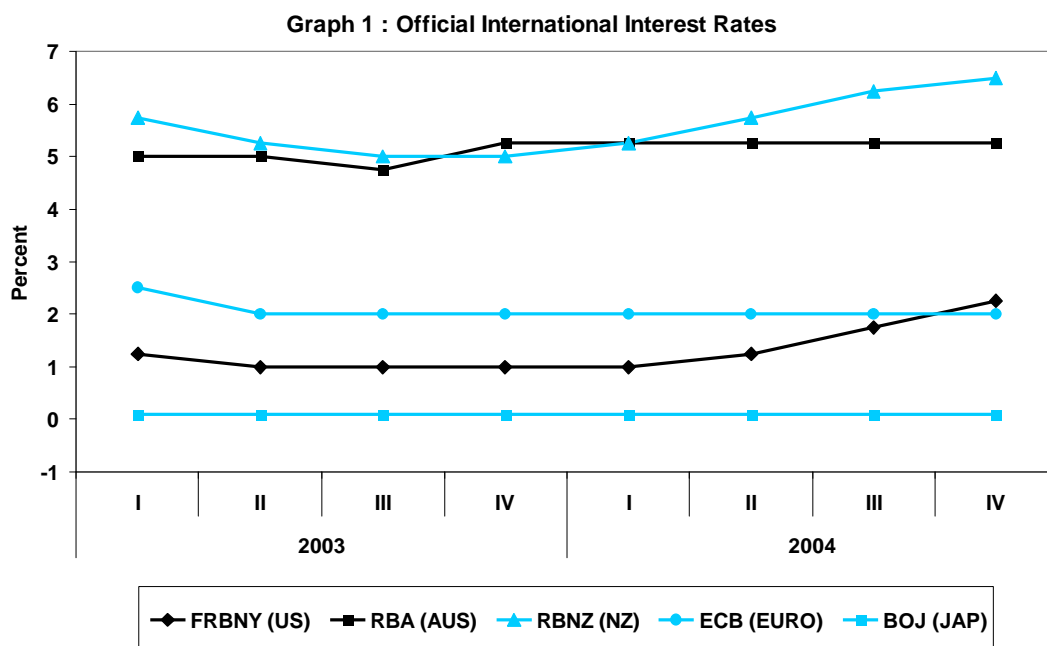


## II. OVERVIEW OF ECONOMIC DEVELOPMENTS DURING THE FOURTH QUARTER OF 2004.

### a. The World Economy

The global economy and financial conditions improved in the December quarter of 2004, led by the United States as the US economy enters its fourth year of recovery. US real GDP growth increased 0.8 percent in the December quarter, to be 3.7 percent higher over the year. This growth was supported by growing consumer spending, resulting in an increase in retail sales and industrial production as well as rising consumer confidence which also rose in December to a 5-month high, led by the favourable outlook for labour market conditions.

In line with market expectations, the Federal Reserve raised its key interest rate twice in the December quarter, by 25 basis points each in November and December, to 2.25 percent. These moves were prompted by expectations of rising inflationary pressures associated with the robust economic growth. (See Graph 1.)



The New Zealand economy continued to grow with GDP expanding by 3.9 percent over the year to the December quarter. Growth has moderated from its rapid pace in early 2004, as activity in housing construction and consumer demand cooled down. Domestic demand remained the main driver of growth. However, net exports was a drag on growth, largely because of weak merchandise exports. Nevertheless, economic data generally indicated stronger growth for New Zealand during the December quarter.

To ward off inflationary pressures from rising house prices and strong domestic consumption, the Reserve Bank of New Zealand increased its official cash rate by a quarter percentage point to 6.5 percent in October.

The Australian economy experienced a broad pattern of slowing GDP growth in 2004. GDP rose 0.1 percent in the December quarter, after increasing 0.2 percent in the September quarter, and growth over the year slowed to 1.5 percent. The slowing output growth was mainly attributed to weak export performance accompanied by strong growth in imports. Notwithstanding this, business and consumer confidence remained very strong during the year.

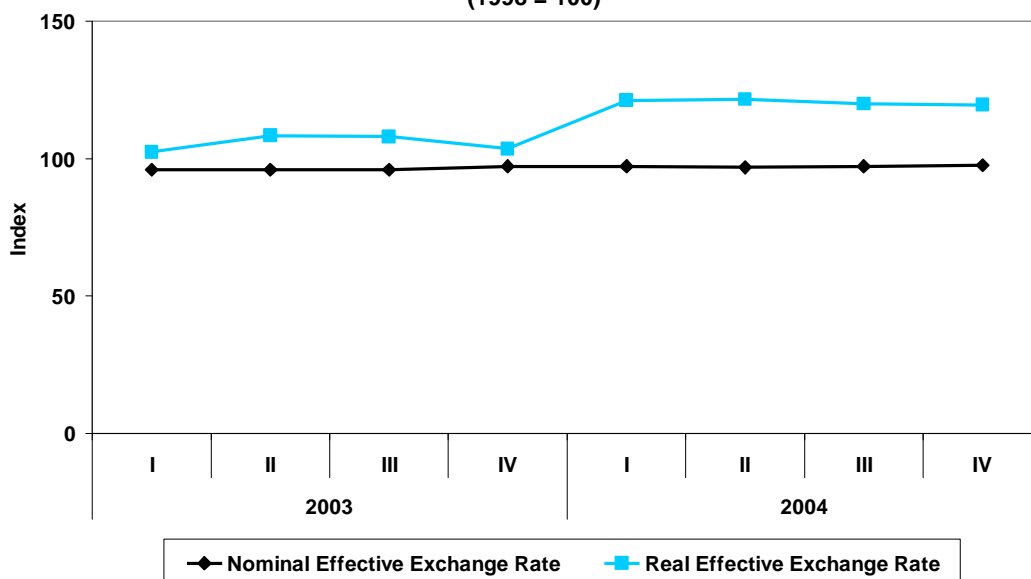
In terms of interest rates, the Reserve Bank of Australia kept its key interest rate unchanged at 5.25 percent, as inflationary pressures abated.

In other parts of the world, economic data from the euro area was disappointing in the December quarter. Euro-wide GDP expanded by 0.3 percent in the September quarter, and year-ended growth eased to 1.8 percent as a result of a fall in export growth. Economic indicators were generally weak. Retail sales for the euro-zone fell for the fourth month in November due to job cuts and a pessimistic economic outlook. In December, the service industries expanded at its slowest pace in more than a year while business confidence fell. In line with subdued economic outlook, the European Central Bank kept its key interest rate unchanged at 2.0 percent during the December quarter. This move was due to expectations of relatively stable consumer prices in the euro-zone.

The Japanese economy recovered in the fourth quarter, but the pace has shifted down since late 2003 and early 2004. Real GDP grew 0.1 percent in the September quarter, having contracted by a similar rate in the June quarter. However, while recent data showed mixed results in the December quarter, in year ended terms, the Japanese economy rose by 2.5 percent. The Bank of Japan is not expected to raise interest rates for some time or until at least 2006. On smaller Asian countries, the tsunami in late December severely affected coastal regions in Indonesia, Thailand, Sri Lanka and India. However, the tsunami disaster is unlikely to have a major impact on aggregate GDP in the Asian region but will reduce growth in the short term in the affected countries. Overall, most observers expect growth of the world economy, though not as strong as last year, to continue in 2005 at an above-average pace for the third successive year.

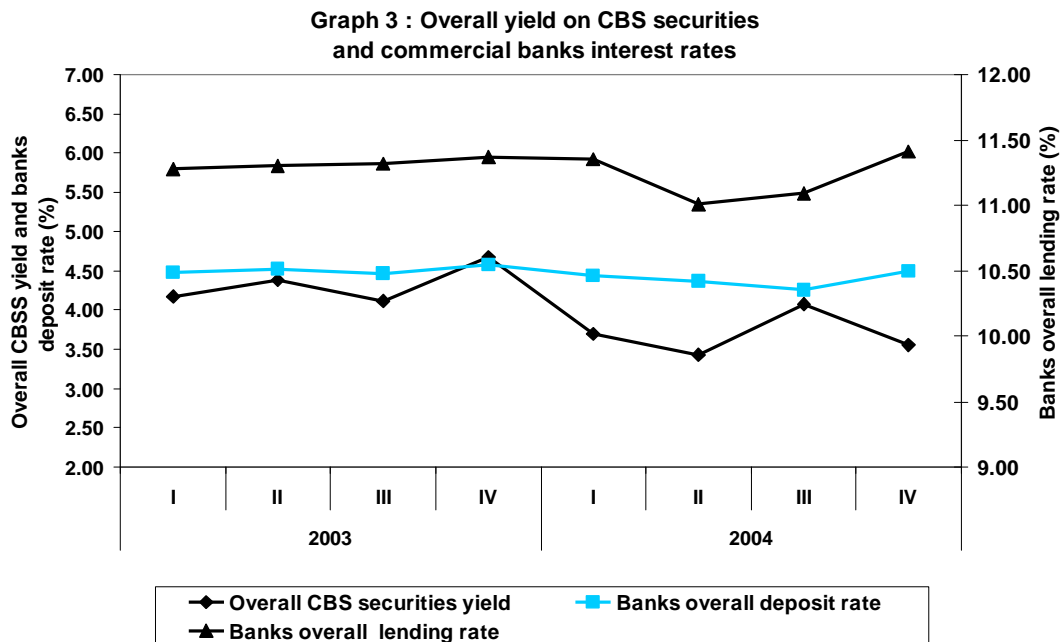
During the quarter under review, the US dollar continued to weaken against the currencies of Samoa’s major trading partners, or conversely, the currencies in the basket strengthened against the US dollar. The strengthening of these currencies in effect led to an appreciation of the Tala against the US dollar, while weakening against the New Zealand dollar, Australian dollar, Euro and the Fijian dollar as these currencies grew stronger. Nevertheless, since the weight of the US dollar in the basket outweighs those of the other currencies, the value of the Tala in terms of its nominal index showed an appreciation of 0.4 percent in the fourth quarter of 2004, easing the pressure of imported inflation on the domestic economy. Furthermore, since prices in Samoa fell, while prices in our major trading partners rose, the real effective exchange rate of the Tala dropped 0.3 percent signaling a gradual improvement in Samoa’s external sector competitiveness. (See Graph 2.)

**Graph 2 : Trade Weighted Exchange Rate Indices  
(1998 = 100)**



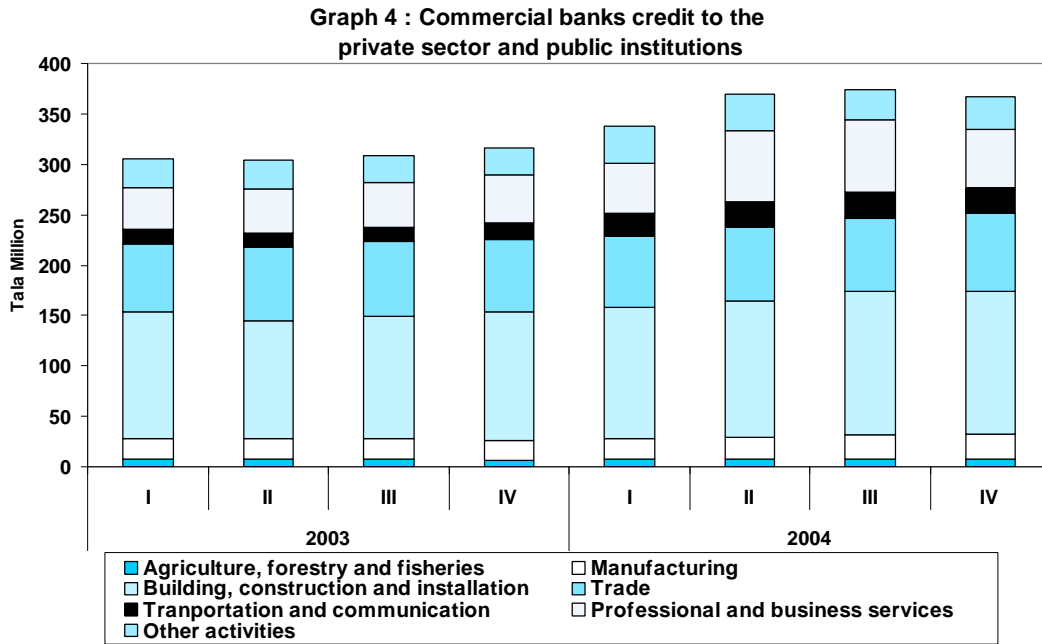
**b. The Samoan Economy**

On the domestic front, both fiscal and monetary policies were aimed at supporting post cyclone Heta rehabilitation and construction activities. On a cash basis, Government’s financial operations in the December 2004 quarter closed in neutral territory with a marginal overall cash surplus of \$0.4 million. On the other hand, in pursuit of its accommodative monetary policy stance, the Central Bank’s monetary operations were aimed at injecting more liquidity into the financial system in order to reduce official interest rates. The underlying rationale was that reductions in official interest rates would in turn drive down market interest rates, thereby increasing private sector demand for credit. However, the limited data collected since the implementation of financial liberalization in January 1998 suggest that there was a time lag<sup>1</sup> between the movements in official interest rates and commercial interest rates. This was evident in the quarter under review where the overall interest rate on Central Bank Securities fell while the commercial banks interest rates went up. In the three months to end December 2004, the weighted average interest rate on Central Bank securities dropped 51 points to 3.56 percent. In contrast, the average commercial bank deposit rate went up 24 points to 4.50 percent and the average lending rate rose 32 points to 11.41 percent. (See Graph 3.)

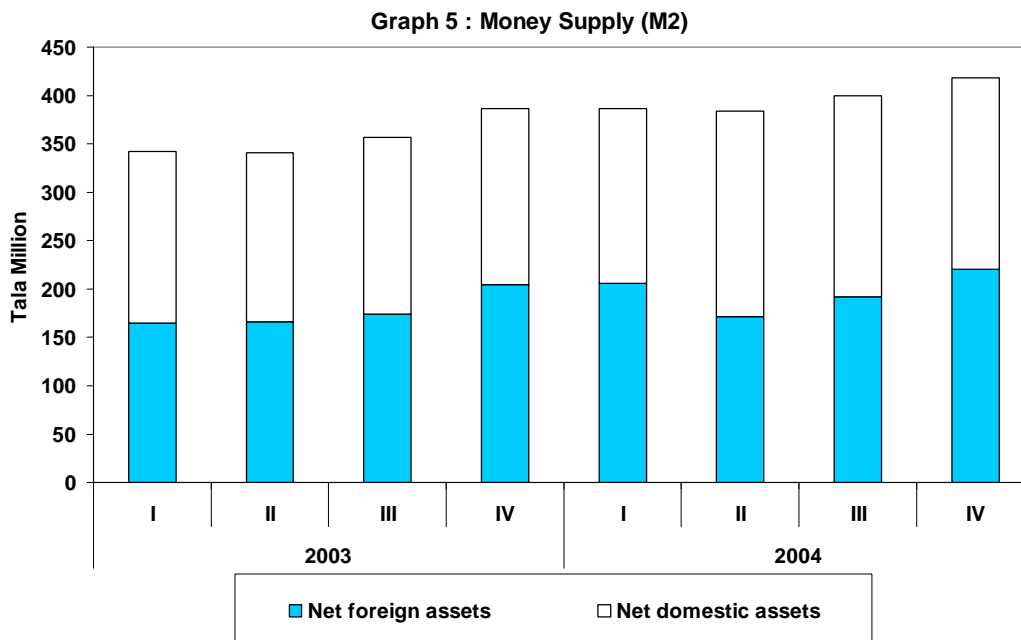


With the rise in the average lending rate, the level of domestic credit fell in the fourth quarter of 2004. In particular, bank credit to the private sector went down \$5.0 million and that to public institutions declined \$2.0 million. (See Graph 4.)

<sup>1</sup> The duration of the lag has, however, been obscured by the entrance of the fourth commercial bank in 2003.

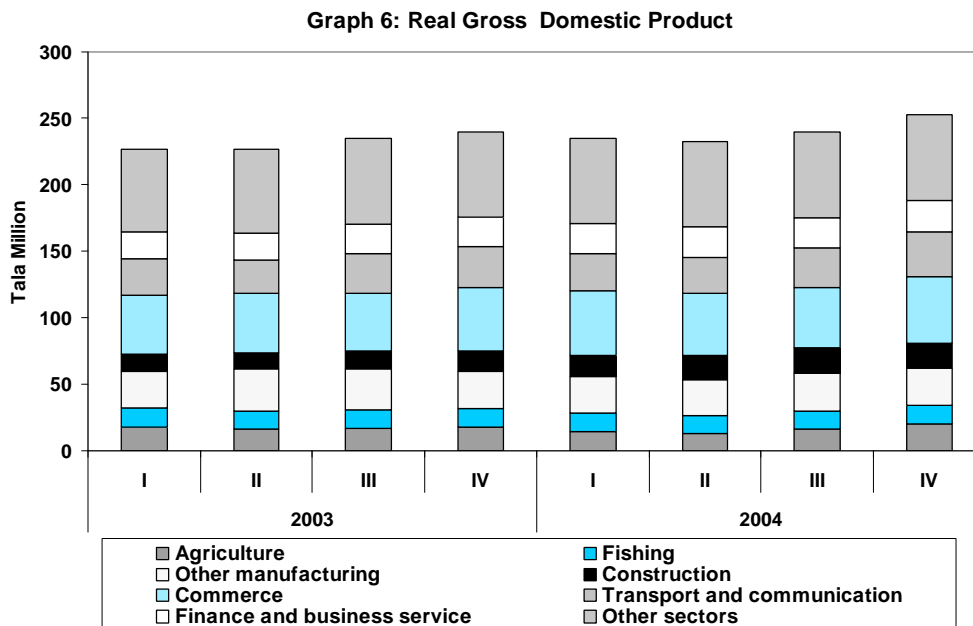


The fall in private sector credit was largely reflected in reduced lending to the “Trade”, “Other activities”, “Transportation and communication” and “Manufacturing” sectors. Despite the reduction in credit to the private sector, total money supply (M2) expanded by a further 4.5 percent in the fourth quarter of 2004, due entirely to a substantial net inflow of foreign funds. (See Graph 5.) Consequently, the contribution of net foreign assets to total money supply went up to 53 percent from 48 percent in the previous quarter. A scan of historical data showed that the external sector tends to impose a domineering influence on money supply in the December quarter each year. This mainly reflects the substantial inflow of private remittances and tourism earnings associated with the end of year festivities.



National accounts figures for the December 2004 quarter showed that the economy grew 4.3 percent in real terms in the quarter under review following growth of 4.4 percent in the previous quarter. (See Graph 6.) The “commerce” sector, which is the largest sector of the economy accounting for about 20 percent of GDP, expanded 5.1 percent in real terms reflecting the upturn of activity associated with the end of year festive season, after slipping a little (0.1 percent) in the previous quarter. “Other manufacturing”, which mainly includes the production of automotive

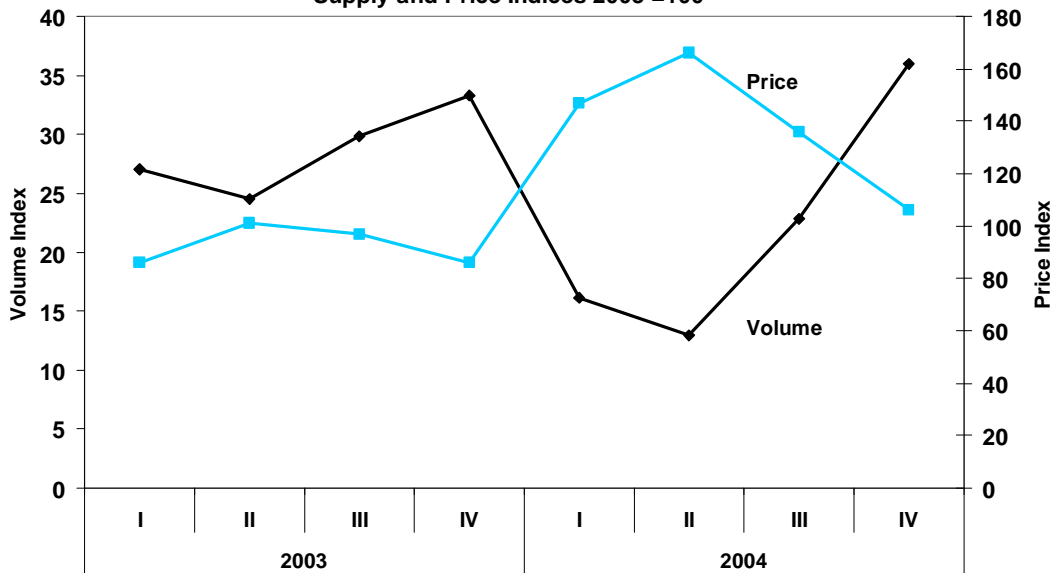
wire harnesses for export and accounting for 12 percent of GDP, edged up slightly (0.6 percent) in real terms after expanding 6.4 percent in the September 2004 quarter. Piggy bagging on the growth in other sectors of the economy, “transport and communication”, which also accounts for about 12 percent of GDP, rose 11.1 percent on the back of a 11.4 percent real growth rate in the previous quarter.



Following real growth of 5.5 percent in the third quarter of 2004, the construction sector output improved a little, edging up 0.4 percent in the December 2004 quarter. The high level of output of the construction sector so far has been sustained by the ongoing cyclone rehabilitation works, construction of sporting facilities for the 2007 South Pacific Games, as well as the construction of new churches, schools and private sector buildings, public roads and bridges. The continued expansion in construction activities saw the production of paint grow 25 percent, ready-mix cement increasing 20 percent and timber up 7 percent. And, following a real recovery of 24.8 percent in the September 2004 quarter, agriculture production, which contributes about 6 percent of GDP, grew a further 22.9 percent in the December 2004 quarter reflecting the continued recovery of farms and plantations around the country. The upward momentum in the exports of nonu products also made a positive contribution to the output of the agriculture sector. The output of the fishing industry, which has been the mainstay of the export sector, showed very little sign of recovering with output in the December 2004 quarter growing by a marginal 1.6 percent after a similar rate of increase in the previous quarter. The fishing industry has been hit hard by poor catch rates with experts putting the blame on the onset of warm ocean temperatures and the likelihood of over fishing.

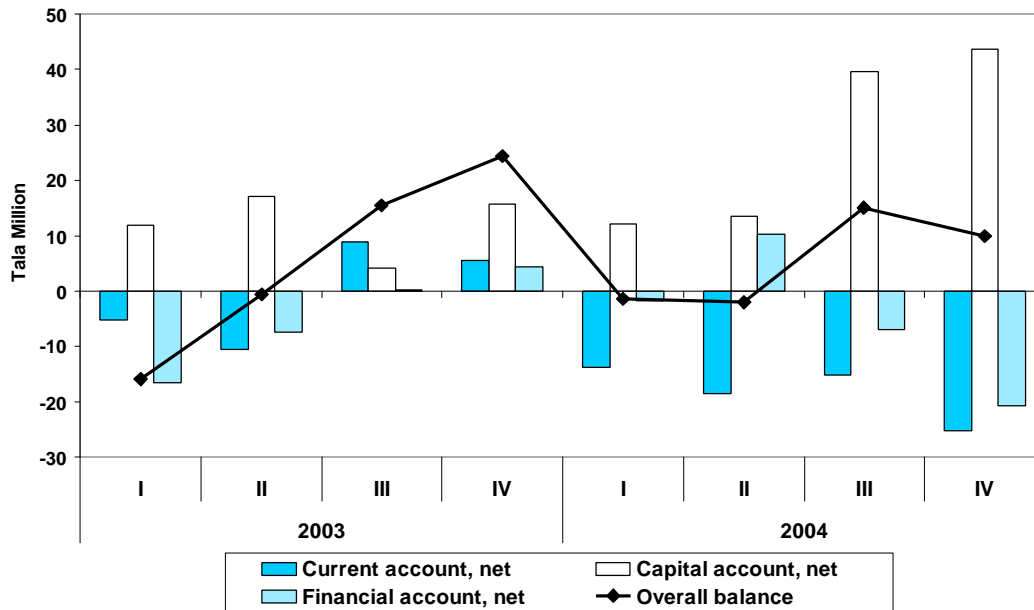
The supply of agricultural produce to the Fugalei Market rose further with their prices consequently declining. This was a clear sign that the agriculture sector was making a steady recovery from the devastation caused by Cyclone Heta. The supply of agricultural commodities to the Fugalei Market expanded 58 percent following a 75 percent increase in the preceding quarter. As a result, the overall price level at the Market declined. (See Graph 7.) Most of the commodities that were surveyed recorded significant increases in supplies. In particular, the availability of banana more than doubled that in the preceding quarter and that of taro almost doubled. When compared to the same quarter of 2003, the overall volume of agricultural produce in the December quarter of 2004 was 8 percent higher while the average level of prices rose 23 percent due to the strong growth in demand.

Graph 7 : Fugalei Produce Market Survey  
Supply and Price Indices 2003 =100



On the external sector, the balance of payments recorded an overall surplus<sup>2</sup> of \$10.2 million in the December 2004 quarter, with a large net inflow in the capital account more than offsetting a slightly reduced current account deficit. (See Graph 8.) Consequently, the level of gross official foreign reserves at the end of the December 2004 quarter was sufficient to cover 6.0 months imports of goods, which was the same as in the previous quarter but was slightly down from 6.2 months in the same quarter the previous year.

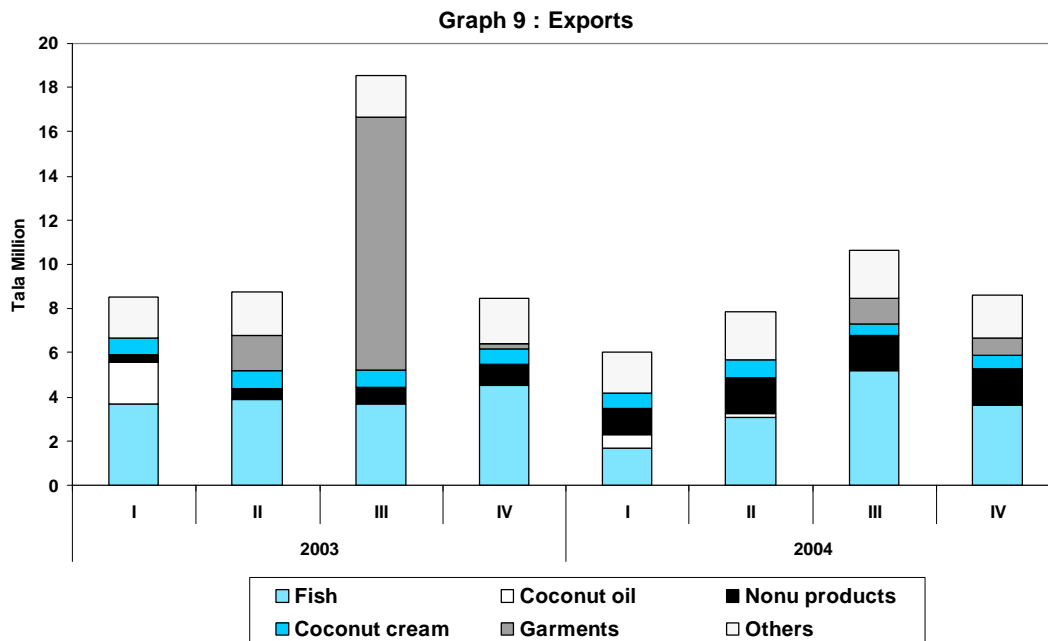
Graph 8 : Balance of Payments



An increase in the foreign trade deficit to \$115.1 million was partially offset by a rise in the net inflow of current transfers to \$79.5 million. The widening in the trade deficit reflected a decline in total export earnings combined with a sharp expansion in imports.

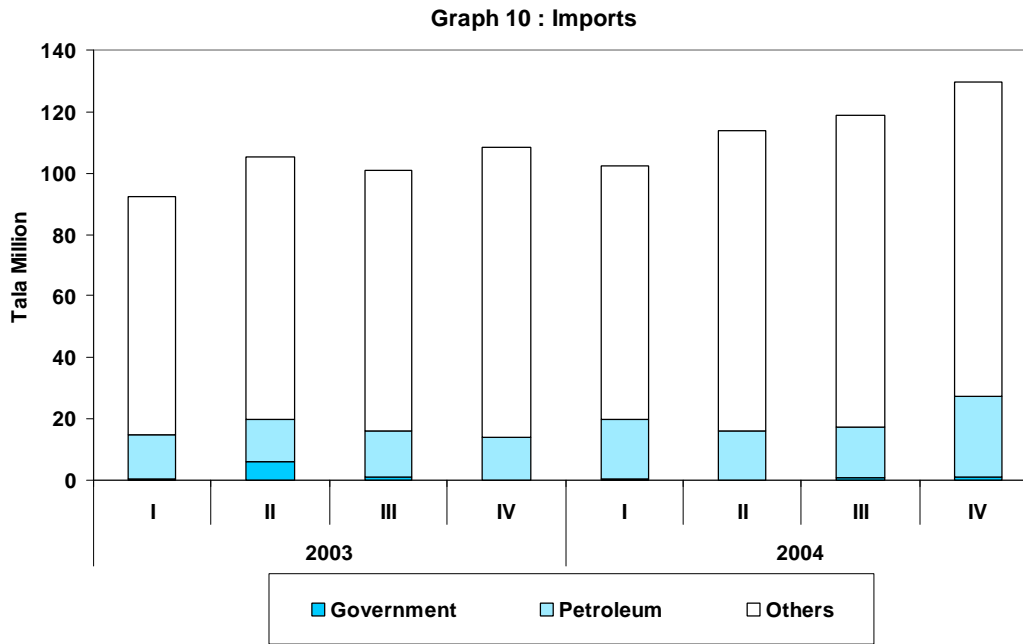
<sup>2</sup> The balance of payments figures have been compiled and published for the first time on the basis of the Fifth Edition of the International Monetary Fund's Balance of Payments Manual. The overall balance is defined as the change in official international reserves. See Section IV Statistical Note.

Exports decreased but were in line with historical trends. The reduction largely reflected the decline in fish and garment exports. (See Graph 9.) A drop of 21 percent in the volume of fish exports combined with an 11 percent reduction in the export price of fish to reduce the value of fish exports by 30 percent in the quarter under review. Garment exports, which were ceased in the first half of 2004 as the garment factory was being relocated to the Vaitele industrial area, resumed in the September quarter. Whilst the average export price for garments remained unchanged, the volume of garment exports fell 29 percent reducing the total value of garment exports by the same margin in the December 2004 quarter. Since the USA is the main market for garment exports, the outlook for garment exports to that country is uncertain given the recently proposed amendments to the US laws governing garment and textile exports to that country. In particular, the requirement that only garments made out of US made yarns qualify for the zero import duty rate, poses a tough challenge to the local garment industry. Furthermore, no more than 14 percent of total garment imports in the US can be non-US yarn made, imported at the zero duty rate.



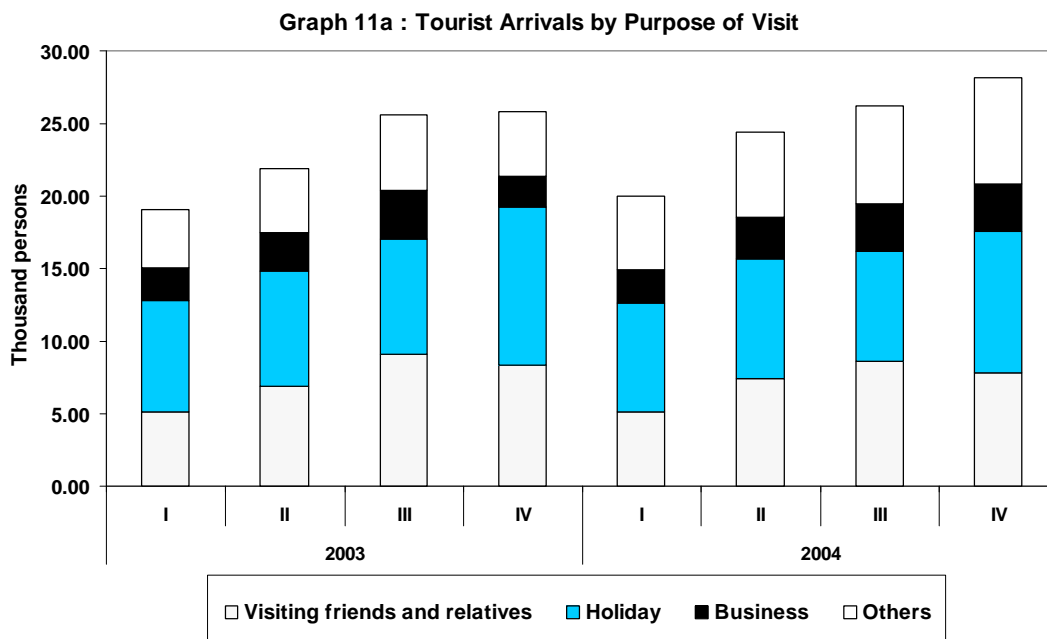
The decline in fish and garment exports overshadowed the increases in other export commodities. The volume of nonu juice and fruit exports strengthened further, increasing 15 percent and 30 percent respectively in the quarter under review. And, despite reductions in their prices, the value of nonu juice and fruit exports rose 6 percent and 4 percent in that order. Slight improvements in the volume and price of coconut cream saw the value of coconut cream exports edge up 3 percent. An increase in the volume of beer exports outweighed a reduction in its price raising the value of beer exports by 5 percent.

Imports grew strongly, rising 12 percent in the quarter under review largely as a result of a dramatic increase in imports of petroleum products. (See Graph 10.) The value of petroleum imports shot up 63 percent reflecting not only the continued increases in the international prices of petroleum products but also the demand for petroleum products which was fueled by the recovery in the domestic economy in the quarter under review. The average spot price for crude oil went up 5.3 percent to \$42.68 per barrel with some industry analysts predicting that it could reach over USD \$100 a barrel. Private sector and Government imports also increased, rising 4 percent and 23 percent respectively.

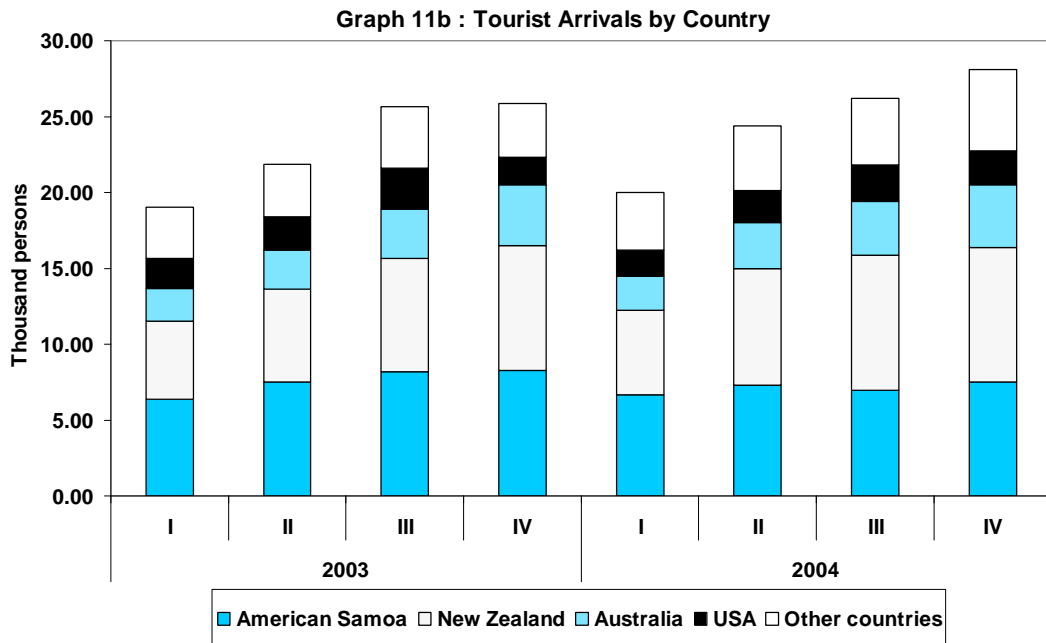


As usual, the fourth quarter was the period when tourism earnings rise as visitors, particularly Samoans who reside permanently overseas, choose to return to spend their holidays with friends and relatives. It is also the period when the inflow of private remittances is strongest due to White Sunday (second week of October) celebrations and Christmas and end of year festivities (the last two weeks of December).

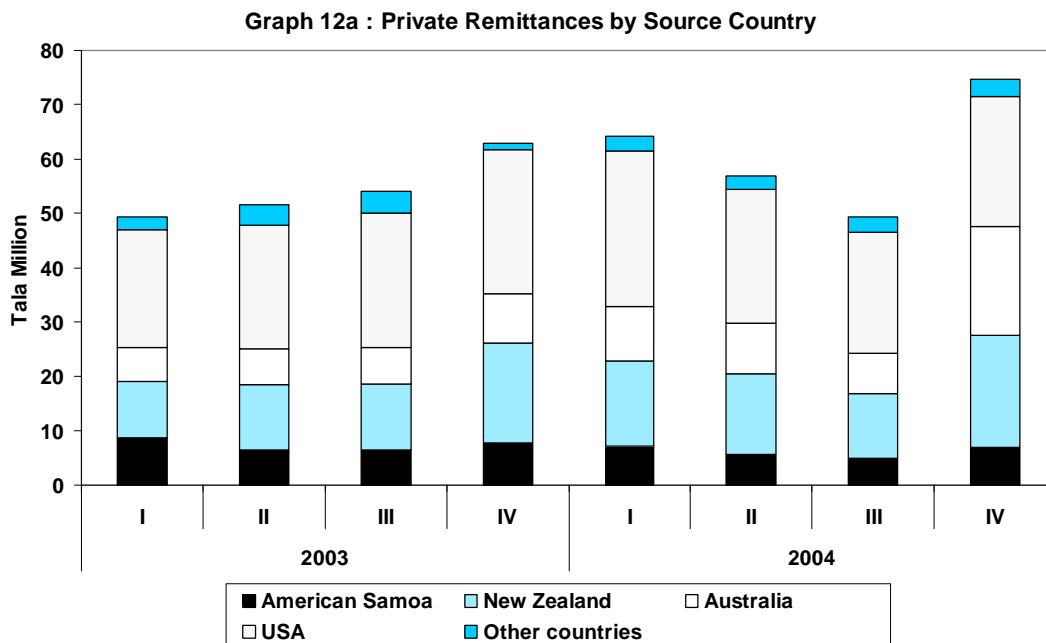
In the December quarter of 2004, tourism earnings rose 4 percent to \$54.6 million and private remittances skyrocketed 49 percent to \$64.4 million. The rise in tourism earnings reflected an overall growth in tourist arrivals combined with an overall increase in average tourist expenditures. In keeping with past trends, those who came for holidays and Samoans residing permanently overseas who came to visit friends and relatives dominated tourist arrival figures in the quarter under review. (See Graph 11a.)



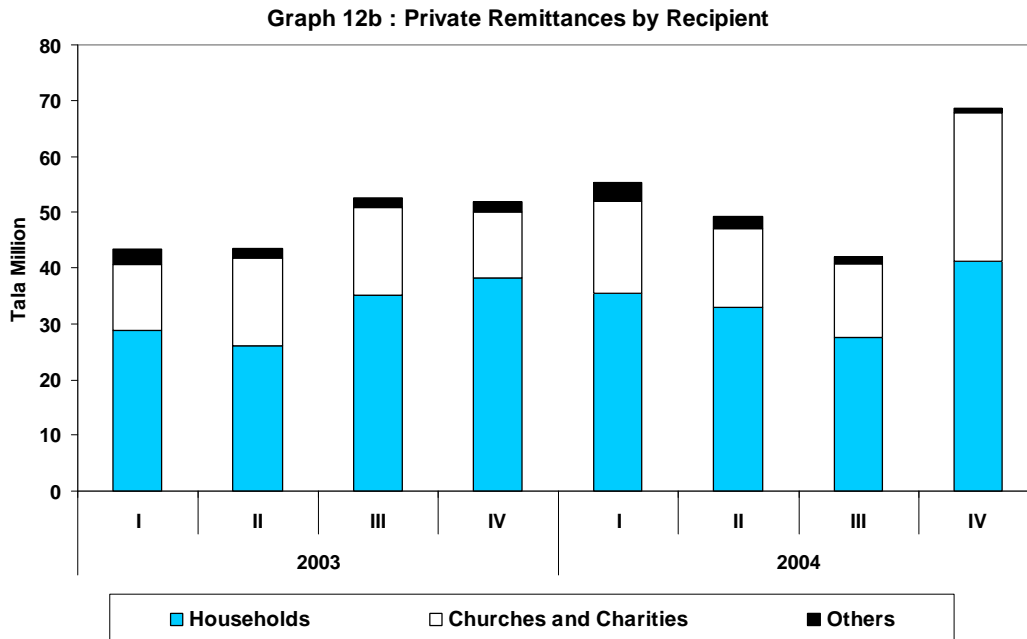
As usual, most visitors came from New Zealand and American Samoa. (See Graph 11b.)



Large inflow of funds for major construction projects of the Latter Day Saints (LDS) Church in Samoa, in particular the new Temple and Church buildings at Pesega, contributed strongly to the high level of private remittances in the quarter under review. USA accounted for the largest proportion of private remittances (32.1 percent) followed by New Zealand (27.7 percent) and Australia (26.7 percent). (See Graph 12a.)



Funds for supporting families and individuals accounted for the bulk of private remittances (55.1 percent) followed by funds for religious organizations and non-government schools (35.7 percent). (See Graph 12b.)



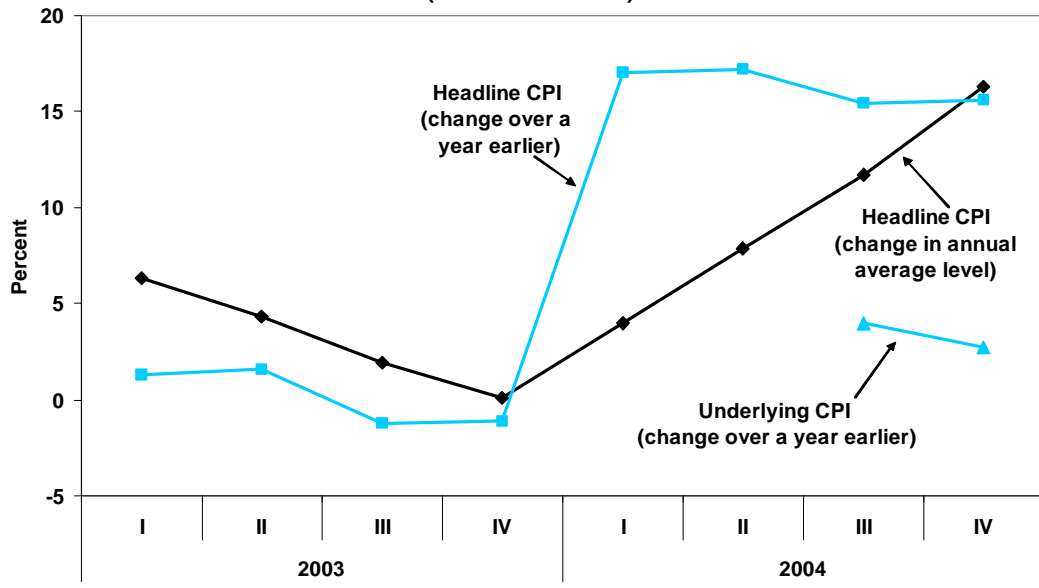
Official external grants that were classified as current transfers (\$15.1 million) in the quarter under review were about 6 percent lower than the level of the previous quarter. These grants comprised of aid for the maintenance, repairs and upgrade of existing infrastructure, cash and commodity grants, technical assistance and funds for institutional strengthening programs (ISP).

The capital account recorded a surplus of \$49.7 million, which was up from \$47.1 million in the previous quarter due to an increase in the net inflow of private sector capital. From about \$0.8 million in the previous quarter, private sector capital inflows rose to \$6.5 million. The bulk of this (\$6.0 million), however, represented the imputed borrowing by a local company from its overseas parent company, which was written off during the quarter when that company was sold. Capital grants received by Government, on the other hand, fell 7 percent to \$43.1 million in the December 2004 quarter, but was almost four times higher than in the same quarter in 2003. A significant portion of these grants was for the construction of sporting facilities in preparation for the 2007 South Pacific Games.

On the financial account, which is a record of the flow of non-reserve assets and liabilities, there was a large net inflow of funds of \$26.7 million. This net accumulation in non-reserve assets and liabilities mainly comprised of a rise of \$20.3 million in foreign currency holdings and overseas deposits, plus a net increase of \$8.0 million in commercial bank loans to overseas branches of local companies. These were partially offset by the write off of the \$6.0 million debt mentioned earlier, a \$2.9 million net outflow in direct investment and a slight net outflow in portfolio investments.

The average level of consumer prices fell 1.3 percent in the December quarter, but was 15.6 percent higher than in the same quarter a year earlier. (See Graph 13.) The decline in the headline Consumer Price Index (CPI) during the fourth quarter mainly reflected the drop in local food prices, particularly at the Fugalei Market, compliments of a gradual recovery in agricultural production from the devastating impact of Cyclone Heta, which struck at the beginning of 2004. The local component of the "Food" sub-index dropped by 6.6 percent and its import component declined 1.1 percent. However, the headline rate of inflation, on an annual average basis, rose to 16.3 percent at end December 2004 from 11.7 percent at end September 2004 and 0.1 percent at end December 2003. The underlying rate of inflation, on the other hand, was much lower at 1.9 percent at the end of December 2004.

Graph 13 : Consumer Price Index  
(March 2004 = 100)



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### III. PRUDENTIAL SUPERVISION

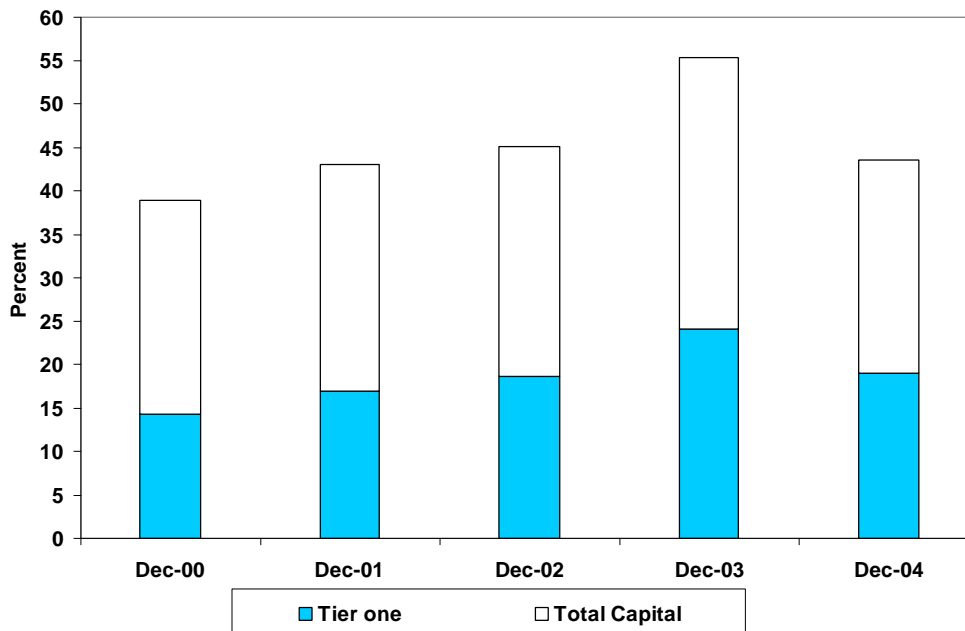
Banks play a vital role in the economic welfare and development of Samoa. They serve as major depositories and intermediaries of funds entrusted to them by the public and are able to channel these funds to the different sectors of the economy. Banks also provide both domestic and international payment services. Given these important roles and the strong public interest in them, the Central Bank of Samoa has been mandated the responsibility for the supervision and regulation of banking institutions through the Central Bank of Samoa Act 1984, the Financial Institutions Act 1996 and the Money Laundering Prevention Act 2000. Broadly, the aim is to promote public confidence in banks and maintain a healthy and stable financial system.

As such, the Central Bank has developed, in close consultation with the commercial banks, prudential standards that serve as triggers for discussions on particular aspects of the banks operations whilst, at the same time, ensuring that such standards are consistent with internationally recognized practices.

One important aspect of the Central Bank's supervisory process clearly emphasizes that the ultimate responsibility for the affairs of a bank resides mainly with its board of directors and management. The Central Bank's focus is towards ensuring that individual banks follow prudent management practices and that prudential standards are constantly kept under review to take account of changing circumstances.

For the quarter ended 31 December 2004, the banking system continued to perform satisfactorily, recording moderate growth of assets, improved profitability performance and maintaining adequate level of capital above the Central Bank's minimum requirement of 15.0 percent. (See Graph 14.)

Graph 14 : Capital Adequacy Ratio



The banks total assets of \$562.4 million reflected a slight drop of 1.0 percent in the December quarter 2004. On an annual basis, total assets grew by 11.5 percent (\$57.9m). The composition of the commercial banks assets comprised largely of loans and advances of \$370.1 million (62.2 percent of total assets), cash reserves and deposits with the Central Bank and other banks combined at \$151.0 million (25.4 percent) and fixed assets of \$52.8 million (8.9 percent).

At \$370.1 million, total loans and advances dropped 2.1 percent (\$7.8 million) at the end of the quarter but still represented a 9.1 percent growth (\$30.7 million) over the year before.

The decline in loans largely reflected decreases in claims on non-financial public enterprises and private sector businesses which more than offset increases in loans to the Government and private households.

There was a marginal growth in deposit liabilities, reaching \$440.3 million at the end of the quarter, due mainly to an overall increase in time deposits. At this level, total deposit liabilities registered an annual growth rate of 11.4 percent (\$45.0 million) when compared to the same period the year before.

One important aspect of the commercial banks balance sheets relate to the potential financial commitments through various financial contracts and arrangements with their customers, primarily of a contingent nature. Honoring such commitments at a future date, could have significant impact on banks balance sheets.

At \$77.8 million, total contingent and off-balance sheet items grew strongly by \$11.7 million as a result of significant increases in unmatured foreign exchange contracts of \$39.4 million and unused credit commitments of \$27.0 million.

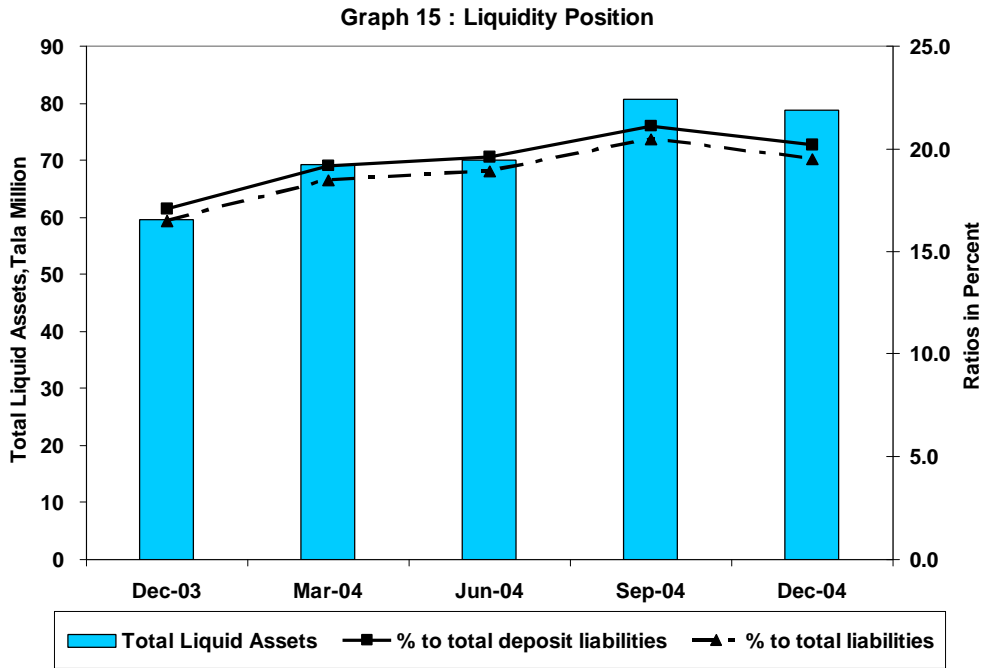
Total capital of the banking system remained strong at \$98.5 million, up from \$97.3 million the previous quarter. Among others, this largely reflects banks profitable performance throughout the period, contributing to an annual growth of \$6.7 million of capital funds.

In proportion to total risk weighted assets, capital adequacy improved by 0.3 percent to 24.5 percent. Tier 1 capital recorded a 19.0 percent ratio, a rise of 2.9 percent over the September quarter.

All the banks complied with the Central Bank's minimum capital adequacy requirement (15.0 percent) at the end of the quarter.

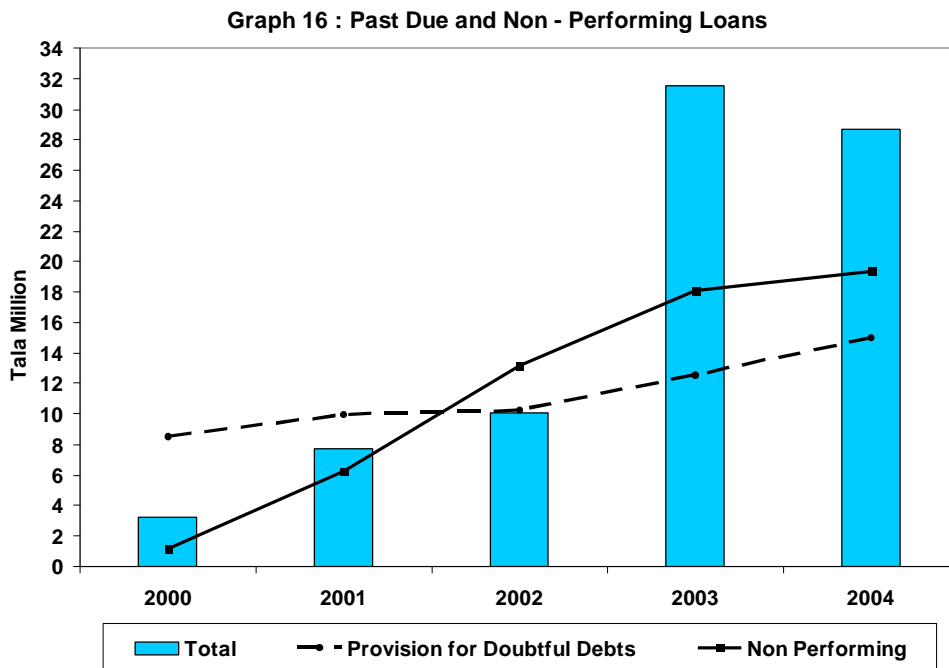
In terms of liquidity, the banking system continued to maintain a high level of liquid assets although it was down slightly when compared to the previous quarter. Total liquid assets amounted to \$78.7 million, equivalent to 20.2 percent of total domestic deposit liabilities, a relatively comfortable position of the banking system to meet short term or immediate financial obligations as they fall due. On an annual basis, liquid assets grew strongly by \$15.3 million (24.1 percent) with Central Bank Securities of \$41.2 million representing 52.4 percent of total liquid assets at the end of the quarter. (See Graph 15.)

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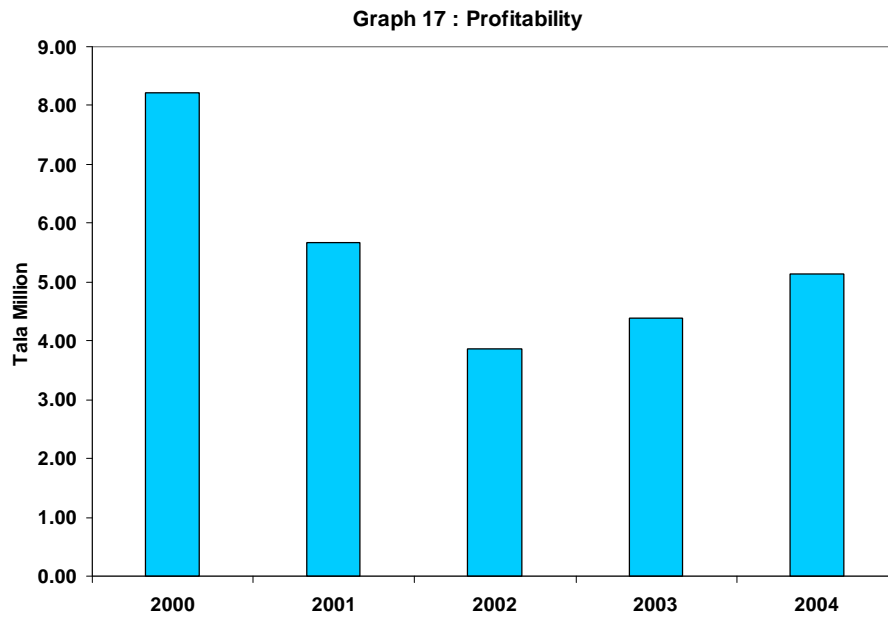


The commercial banks have continued to operate actively in the management of their foreign exchange transactions, recording moderate increases in both foreign assets of \$63.6 million and foreign liabilities of \$57.7 million which resulted in a combined net exposure long position of around \$6.7 million or 6.8 percent of total capital.

One of the major challenges faced by the commercial banks is the noticeable rise in the level of non-performing loans, which reflected an annual growth of \$1.3 million to reach \$19.3 million at the end of December 2004. Accordingly, the commercial banks have been advised to be extra vigilant in their approaches towards asset quality reassessments and provisions being recorded to cover for possible write offs of non-performing assets from their books while efforts to expedite recoveries are pursued. (See Graph 16.)



At a combined figure of \$7.1 million, the banking system’s pre tax profit level grew by 10.9 percent in the quarter under review, compared to the same period the year before. Among others, net interest income is the main source of the commercial banks income. (See Graph 17.)



For the period under review, total operating expenses represented 72.2 percent of total income, up from 70.8 percent in the previous year. The banks also continued to achieve good earnings from their non-interest earning activities such as commission, charges and fees and foreign exchange gains.

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#### **IV. MONETARY POLICY IN THE SECOND HALF OF THE 2004/2005 FINANCIAL YEAR**

##### **a. Introduction**

On 4 March 2005, the Central Bank's Board of Directors reviewed the reports on the more recent economic developments, updated monetary forecasts and the required stance for monetary policy in the remaining months of the financial year 2004/05.

As expected, inflation accelerated reaching 16.3 percent at the end of December 2004 due to the adverse impact of Cyclone Heta on food supplies. The latest forecasts showed inflation, both headline and underlying, heading downwards in the remaining months of fiscal year 2004/05. Large inflows of private remittances, tourism earnings and short-term capital saw the level of foreign reserves increase in the seven months to end January 2005 and they were expected to remain strong during the rest of the financial year. On the other hand, real economic growth was in positive territory but was softer than expected. As a result, the Board decided to continue easing monetary conditions in the remaining months of the year in order to boost the growth of credit to the private sector, thereby strengthening real economic growth.

##### **b. Key Developments In The World Economy**

The global economy recorded an exceptional real growth rate of around 5 percent in 2004 despite threats posed by surging oil prices, monetary policy tightening around the world and continuing current account imbalances in the world's major regions. USA and China were the key drivers of this exceptional world economic growth, consequently contributing to the upward pressure on international oil prices. Supply and security concerns were also noted in several major oil-exporting countries including Iraq, Russia and Venezuela.

In 2005, the global economy is expected to continue to perform well although it would be slightly lower than its performance in 2004. The increase in oil prices, rising US interest rates and on-going geopolitical uncertainties will continue to be felt in 2005. Furthermore, fiscal policies are also expected to be less stimulatory in most major economies. The main challenge to global economic growth is the possibility of a rapid or prolonged US dollar depreciation, plagued by the expanding US budget and current account deficits.

##### **c. Domestic Policy Developments**

Although up to date Government Financial Statistics were not available at the time the forecasts were compiled, the latest data showed that Government's net position with the monetary system improved in the seven months to end January 2005 reflecting a cash surplus of \$6 million.

In line with the expansionary stance of monetary policy that was adopted for the financial year 2004/05, the Central Bank's open market operations in the seven months to end January 2005 focused on injecting more liquidity into the financial system to increase loanable funds and to boost the demand for credit. The overall level of commercial banks' free liquidity grew from \$23.6 million at the start of the financial year to \$31.2 million in January 2005. There were no long-term (12 months) Central Bank securities issued and the weighted average yield on the benchmark 91-day paper was reduced from 4.90 percent to 4.87 percent. Despite the decline in official interest rates, the weighted average lending rate of the commercial banks rose 40 points from 11.01 percent in June 2004 to 11.41 percent in December 2004 before falling to 11.36 percent in January 2005. It appeared from the historical figures that there was a time lag between the movements in official interest rates and commercial interest rates.

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After rising slightly (up 1 percent) in the third quarter of 2004, bank credit to the private sector and public institutions combined fell in the following quarter. Overall, therefore, bank credit to the private sector and public institutions combined decreased 1 percent in the first half of fiscal year 2004/05. Obviously, the weak demand for credit in the six months to end December 2004 reflected the upward trend in the commercial banks lending rates. However, there was a very large net inflow of foreign funds in the six months to end December 2004 which, consequently, increased money supply (M2) by 8.2 percent since the start of the 2004/05 financial year.

In the six months to end December 2004, the exchange rate of the Tala appreciated 0.6 percent in nominal terms. During that period, the Tala appreciated 6.5 percent against the US dollar but depreciated 5.4 percent and 4.6 percent against the NZ and Australian dollars respectively.

#### **d. External Sector Developments**

Compared with the first half of fiscal year 2003/04, exports in the first half of 2004/05 fell substantially (down almost 30 percent to \$19.3 million) mainly reflecting the significantly reduced value of garment exports (down 83 percent) and slightly lower exports of coconut cream. The reduction in garment exports reflected the absence of any garment order from the highly lucrative UK market. Instead, garment orders were received from the USA, which is the usual destination for inexpensive garment exports. The value of fish exports, the main source of export revenue, increased 7 percent reflecting an improvement in its export price whereas the volume exported went down 2 percent. Nonu exports performed remarkably well with earnings virtually doubling to \$3.3 million. Given the dismal performance of exports in the first six months of the financial year, the forecast total export earnings in 2004/05 was reduced from the original forecast of \$40.5 million to \$35.3 million.

In the six months to end December 2004, imports grew 17 percent when compared with the same period in 2003. This increase, which largely reflected the expansion in petroleum and private sector imports, was a little lower than anticipated, consequent to a slower than expected growth in the economy. The forecast level of total imports in 2004/05 was therefore reduced from the original forecast figure of \$520 million to \$512 million.

Foreign exchange earnings from tourism in the six months to end December 2004 were higher than they were the year before, with the safer and more secure conditions in the South Pacific driving up the total number of visitors to Samoa. This positive trend is expected to continue in the first half of 2005. Consequently, earnings from tourism in fiscal year 2004/05 were revised up from the original forecast level of \$199 million to \$204 million.

In the same six months period, private remittances were 6 percent lower than they were a year earlier with the large inflow of funds for the construction of the LDS Temple at Pesega accounting for the higher level of remittances in the July-December period in 2003. Consequently, the forecast level of remittances for fiscal year 2004/05 was revised down from \$213 million to \$193 million.

Net earnings from the assembly of automotive wire harnesses were about a third lower in the six months to end December 2004. As a result, revenues in 2004/05 as a whole have also been revised down from the original forecast figure of \$28 million to \$20 million.

On investment income, better than expected returns from foreign exchange deposits overseas led to a higher than expected level of earnings. Accordingly, the forecast inflow of investment income was increased from the original forecast figure of \$9 million to \$10 million. On the other hand, outward payments in the six months to end December 2004 were much higher than in the previous year. In the remaining six months of the financial year, one of the commercial banks will be

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remitting some of its accumulated profits overseas. For the financial year 2004/05, therefore, outward payments were expected to double to \$28 million.

On the capital account, no actual figures were available on Government capital flows in the six months to end December 2004. Consequently, no significant revision was made to Government capital flow forecast figures. On private capital flows, the figure of \$21.9 million reflect the receipt of repayment of short-term loans to local companies operating overseas and funds for the construction of a hotel project.

Together with the growth in tourism, large capital inflows in the six months to end-December 2004 should see the balance of payments generate an overall surplus of close to \$30 million in fiscal year 2004/05 despite the anticipated sharp rise in imports of goods and services.

#### **e. Real Economic Growth**

The national accounts figures for the December 2004 quarter were not available at the time the forecasts were revised but estimates indicated that real GDP grew 3.0 percent in the six months to end December 2004 (when compared with the same period in the previous year) led mainly by an estimated 35 percent expansion in construction activity, an 18 percent growth in the tourism sector, a 5 percent increase in the commerce sector and a 3 percent growth in the agriculture sector. On the negative side, the fishing industry continued to perform poorly with output for the sector estimated to fall 14 percent. Therefore, on the basis of the prevailing trends, all sectors of the economy were expected to record positive growth rates in the six months to end June 2005, except for the fishing industry, which was expected to decline further when compared with the same period in 2004. Growth in the second half of 2004/05 was anticipated to come mainly from a projected 10 percent each growth in the outputs of the agriculture and construction sectors respectively and a 8 percent increase in the tourism sector. For 2004/05 as a whole, therefore, real growth was expected to slow down from the original forecast of 3.0 percent to 2.6 percent mainly reflecting the pessimistic outlook for the fishing industry following the prolonged threat of more cyclones at the beginning of 2005, continuation of the El-nino phenomena and possibly over fishing.

#### **f. Price Developments**

As expected, the headline annual rate of inflation climbed steeply in the six months to end December 2004 reaching 16.3 percent at the end of that period before slowing down to 15.7 percent in January 2005. The abrupt and continuing rise in the prices of local commodities following Cyclone Heta in January 2004, the upward spiraling of petroleum prices and strong domestic demand were the main causes for the unrelenting acceleration in the rate of inflation in the period under review. The overall price level at the Fugalei Market rose 32 percent in the first half of fiscal year 2004/05 largely as a result of reduced supplies in the third quarter of 2004, and the international price of crude oil rising higher and higher.

The figures for January 2005 indicate that the headline rate of inflation was already starting to decelerate as the supplies of local produce recover to normal levels. By end June 2005, the headline rate of inflation is forecast to decline to 7.2 percent from the original forecast of 7.9 percent. On the other hand, the underlying rate of inflation is expected to fall to from 1.7 percent in January 2005 to zero in June 2005.

#### **g. Monetary Policy Stance For The Second Half Of 2004/2005**

Based on the figures available at the time the forecasts were compiled in March 2005, the macro-economic outlook for the remaining months of fiscal year to end June 2005 appeared favourable, with a substantial projected overall surplus in the balance of payments. Furthermore, the headline inflation rate was already trending downwards with the underlying rate of inflation expected to fall to zero by June 2005. On the other hand, the economy managed to stay in positive territory

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with estimates at the time showing real GDP growing 1.5 percent in the twelve months up to end December 2004. Given the adverse impact of Cyclone Heta in January 2004, this growth rate was a welcomed achievement and it was in line with the focus of monetary and fiscal policies during the financial year. For the remaining half of 2004/05, therefore, the Central Bank Board decided for monetary policy to remain eased to support fiscal policy in boosting real economic growth.

In pursuing this monetary policy stance, the Bank's open market operations was poised to continue to inject more liquidity into the financial system with the aim of driving market interest rates down in order to boost private sector demand for credit. This monetary policy stance would be reviewed once the outlook for the Government Budget for fiscal year 2005/06 is finalized.

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**V. PRESS RELEASE****MONETARY POLICY STANCE FOR THE SECOND  
HALF OF THE 2004/05 FINANCIAL YEAR**

The Central Bank of Samoa's Board of Directors, at its Meeting on 4<sup>th</sup> March 2005, resolved to continue with its easy monetary policy stance to support economic growth especially in the remaining months of the current fiscal year July 2004-June 2005. Effectively, the Central Bank is encouraging a reduction in the commercial banks' interest rates.

This decision follows the review of economic developments in the previous twelve months, taking into account the latest national accounts figures, the balance of payments position, prices and monetary statistics. Available data reflect that positive progress was achieved in the performance of the economy in the six months to end December 2004 and the forecast for the latter six months to end June 2005 is favourable, albeit slower than the first half.

In the first six months of fiscal year 2004/05, the economy grew 3.3 percent while the level of our foreign exchange reserves remained well above 5 months of import cover. The annual rate of inflation, which shot up steeply during the twelve months of 2004 (mainly as a result of Cyclone Heta), peaked at the end of the year at 16.3 percent and is now on a downward trend as agricultural production continues to recover from the adverse effects of Heta. In February 2005, the inflation rate declined to 14.1 percent from 15.7 percent in January.

The recovery in agriculture production and the continuing growth in the construction and tourism sectors will contribute to further growth in the economy in the second half of the fiscal year. However, due to the expected deterioration in the performance of the fishing industry plus a forecast reduction in remittances, the economy is expected to slow down in the second half of this fiscal year. As a result, our GDP is envisaged to grow by about 2.6 percent in the twelve months to end June 2005.

The growth in bank credit to the private sector and public enterprises in the six months to end December 2004 remained weak, despite a substantial increase in commercial banks' free liquidity. The weak demand for bank credit reflected the upward trend in the commercial banks lending rates which reached an average of 11.4 percent in December 2004.

A reduction in interest rates, the Central Bank Board feels, should encourage more private sector investment preferably in more development related projects.

The Central Bank will continue to monitor developments closely in the period ahead.

**CENTRAL BANK OF SAMOA  
4 MARCH 2005**

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## VI. STATISTICAL NOTE

### 1. Financial Year Figures

Starting with this issue of the Bulletin, except for a few tables, all of the annual figures shown in the statistical tables are for financial year periods, which start on 1 July and end on 30 June. This change brings the Bulletin in line with the adoption by Government and the Central Bank of the financial year as the basis for their budgetary operations and policy formulation.

### 2. New Balance Of Payments Methodology Adopted

Also, beginning with this issue of the Bulletin, the balance of payments figures will be published in accordance with the Fifth Edition of the International Monetary Fund's Balance of Payments Manual. The IMF Manual is the standard on which all members of the Fund compile balance of payments statistics. The adoption of the Fifth Edition of the Manual is in line with Samoa's intention join the IMF's General Data Dissemination System (GDDS).

The project to shift the balance of payments compilation methodology from the Fourth Edition to the Fifth Edition of the Manual has taken two years to complete due mainly to the need to collect more detailed information from various sources, especially data on foreign investment flows. Data availability is still the main constraint to compiling these figures. Technical assistance for the project was provided by the International Monetary Fund through the Pacific Fund for Technical Assistance and Cooperation (PFTAC).

The most noticeable technical differences between the new balance of payments figures and the previous ones are:

- a. The shifting of the "current" portion of Government transfers to the current account. Under Manual 5, the current component of external grants (which is mostly aid for the maintenance, repairs and upgrade of existing infrastructure, cash and commodity grants, technical assistance as well as funds for institutional strengthening programs (ISP)) are to be classified under the current account as Official transfers while the capital part of external grants (funds for construction of new projects such as roads, bridges, buildings etc) are to be classified as Official capital transfers;
- b. The separate identification of movements in non-reserve financial assets and liabilities that were previously classified under the capital account;
- c. The redefinition of official reserves to cover only the gross reserve assets held by the Central Bank and the Ministry of Finance. Previously, the foreign exchange assets held by the commercial banks were counted as part of official reserves. These have now been reclassified as part of the Financial Account; and
- d. The redefinition of the overall balance of payments surplus or deficit as being the change in gross official reserve assets. Previously, the overall balance of payments surplus or deficit referred to the change in the combined net foreign assets held by the Central Bank, Ministry of Finance and the commercial banks.
- e. The Net Errors and Omissions (NEO), which is a balancing item under Manual 5 has been reduced substantially.

In the new balance of payments presentation, the private remittances figures have been broken down into its two main recipient groups – households and charitable organisations.

### 3. Report On The Health Of The Financial System

This Bulletin also marks the first time in which a report will be published on the health of the domestic financial system. This report was only issued once a year and was published in the Central Bank's Annual Reports. Publishing it on a quarterly basis brings Samoa in line with current international best practices.

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