

II. OVERVIEW OF ECONOMIC DEVELOPMENTS DURING THE THIRD QUARTER OF 2007

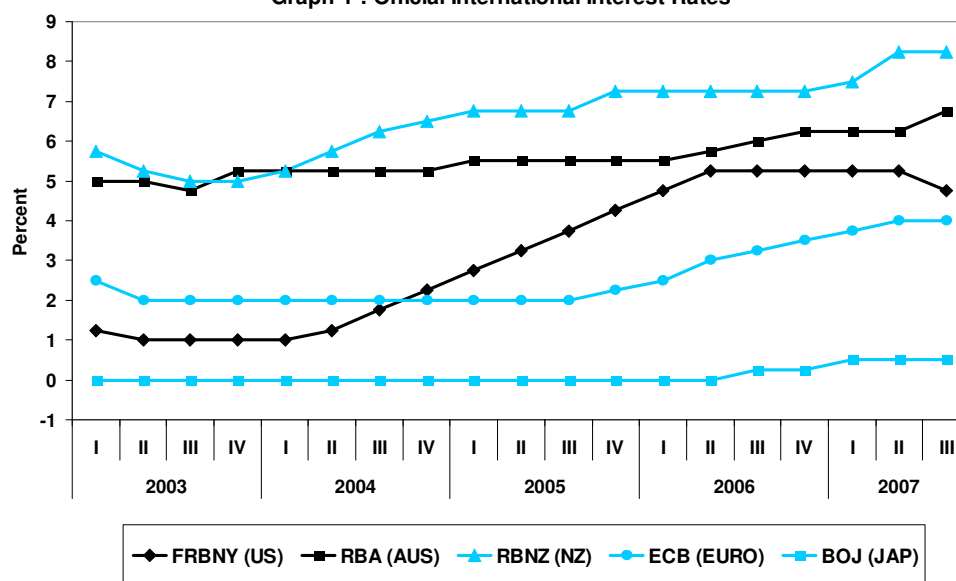
a. The World Economy

The world economy grew strongly in the September quarter of 2007. While momentum appeared to have remained solid in the third quarter for most economies, global financial markets experienced significant turbulence as the fallout from the worsening conditions in the US housing sector led to a general re-pricing of risk across a range of assets. In response to these developments, forecasters have revised down their outlook for global growth. Weaker growth is expected for the United States, where growth has been below trend for the past year due to ongoing problems in the housing sector. Forecasts for Japan and the euro area have been revised down too, reflecting both domestic and external factors.

Data from the US in the September quarter indicated that moderate growth is continuing, notwithstanding the downturn in housing construction. GDP grew 1.0 percent in the September quarter and by 2.6 percent over the year. Consumption growth was solid in the September quarter after posting a weak result in the previous quarter. It increased 0.7 percent, to be 3.0 percent higher over the year, aided by strong growth in real household disposable income. Modest growth in business investment continued as it recorded an increase of 1.9 percent in the September quarter, to be about 5 percent higher over the year. Exports grew at a healthy pace in the quarter, and are expected to be boosted further by the depreciation of the US dollar. Otherwise, activity in the US housing market continued to weaken as residential investment fell 5 ½ percent in the September quarter and by 24 percent over the year. Construction activity is expected to fall further given the weakness in forward indicators such as housing permits and the high level of unsold new homes. Over the same period, measures of underlying inflation moderated in line with the slower pace of growth in economic activities.

In its second meeting in the September quarter, the Federal Open Market Committee (FOMC) decided to lower the Fed funds rate by 50 basis points to 4.75 percent. The intention was to help forestall some of the adverse effects on the broader economy that might otherwise arise from the disruptions in financial markets and to promote moderate growth over time.

Graph 1 : Official International Interest Rates



Recent data showed that the Australian economy continued to perform strongly in the third quarter of 2007. Retail sales posted a larger rise in the quarter and employment continued to expand. Business surveys report that trading conditions in the quarter were well above average. Domestic demand continued to grow strongly, with consumption, business investment and public spending all making significant contributions. At the same time, there has been a modest pick-up in the growth of export volumes, notwithstanding recent declines in rural exports. The Consumer price index for the September quarter rose 0.9 percent to a level 3.0 percent higher than last year.

In the September quarter, the Reserve Bank of Australia decided to increase the cash rate by 25 basis points to 6.50 percent. The Board's decision was based on economic data that signaled a pick-up in the pace of growth in demand and activity. These conditions have been accompanied by higher-than-expected underlying inflation.

In New Zealand, data for the September quarter showed that the housing market continued to slow. Indicators of consumer spending released were mixed. Consumer confidence was higher, despite higher petrol prices and the elevated level of interest rates. Annual inflation eased in the September quarter although it is expected to be short-lived, given that inflationary pressures and capacity constraints remain. The outlook for economic growth remains stable, while trade data hinted that the current account deficit may continue to narrow.

In the September quarter, the Reserve Bank of New Zealand raised its official cash rate by 25 basis points to 8.25 percent. The continued tight labour market, high capacity use and rising oil and food prices all pointed to sustained inflationary pressures and were the reasons for the increase in interest rates.

Economic growth in the euro area slowed in the third quarter of 2007, with the moderation in growth broad-based across the countries. Growth has been slower in the Euro area due to a moderation in business investment. Nonetheless, business conditions remained at high levels, despite the large appreciation of the Euro. Household consumption growth has also been solid with labour market conditions continuing to improve, reducing the unemployment rate to 7.3 percent in September. Core inflation in the Euro area was steady at 1.8 percent.

The European Central Bank (ECB), in its September quarter interest rate review, left its interest rate unchanged at 4.0 percent. The ECB continued to highlight their concern over the inflation outlook.

The United Kingdom continued to expand at a solid pace, with GDP increasing 0.8 percent in the September quarter. Despite a run on deposits at one of the UK's fifth largest mortgage lender, consumer sentiment remained firm in October with other indicators suggesting that the economy has continued to grow solidly. Headline inflation has eased to below the Bank of England's target of 2 percent, with year-ended inflation in September at 1.9 percent.

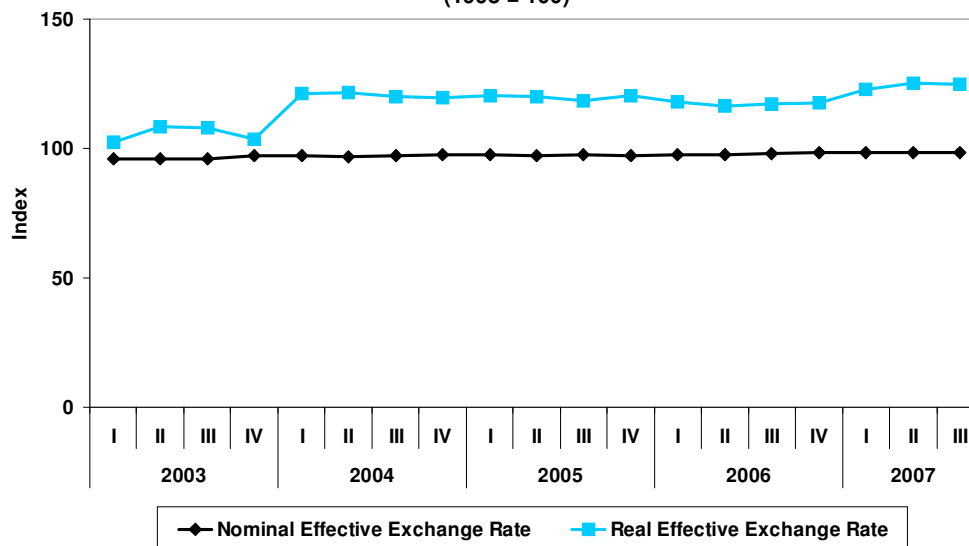
In the September quarter, the Bank of England decided to raise its official cash rate by 0.25 percent to 5.75 percent from 5.50 percent. The Monetary Policy Committee judged that the balance of risks to the outlook for inflation in the medium term continued to lie to the upside.

In Japan, recent data suggested a firmer picture in the September quarter. Growth of industrial production has been solid and picked up in the quarter. Business conditions remained positive, capacity utilisation was high and corporate balance sheets were healthy. Labour market conditions were also favourable. Employment growth has been solid and the unemployment rate at around its decade low. During the September quarter meetings, the Bank of Japan decided to leave its target for the uncollateralized overnight call rate unchanged at 0.50 percent. The market, however, is not certain that there will be room to increase interest rate in the next six months.

The US dollar initially rose against most other currencies amid the financial market uncertainty in the September quarter. However, the combination of weaker-than-expected US economic data, the easing by the Fed and expectations of a further decline in interest rate differentials with other economies contributed to a sizeable depreciation in the dollar over the latter part of the period.

Against the currencies of our major trading partners, the Tala appreciated against the New Zealand dollar and the US dollar but depreciated against the Australian dollar, Euro and the Fiji dollar. The value of the Tala in terms of its nominal index showed an appreciation of 0.10 percent in the third quarter of 2007. Furthermore, since price rises in Samoa were less than in our major trading partners, the real effective exchange rate of the Tala fell 1.98 percent.

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

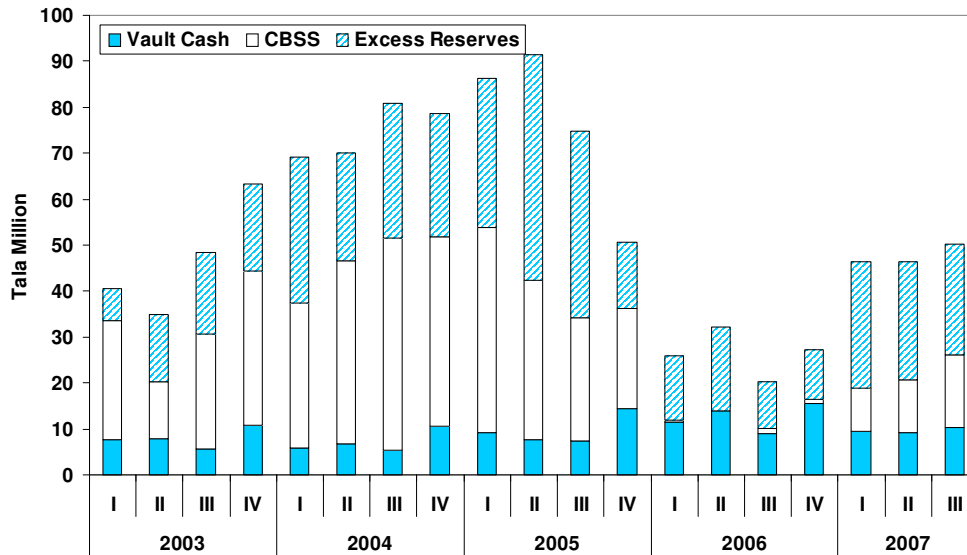


b. The Domestic Economy

Monetary policy remained tightened in the third quarter of 2007 as the country hosted the 13th South Pacific Games. Government's fiscal operations vis-à-vis the monetary system registered a significant cash deficit of \$33.9 million, after recording a cash surplus of \$17.2 million in the previous quarter. This huge drawdown in Government's net deposits in the September 2007 quarter was the largest quarterly decline in over four years.

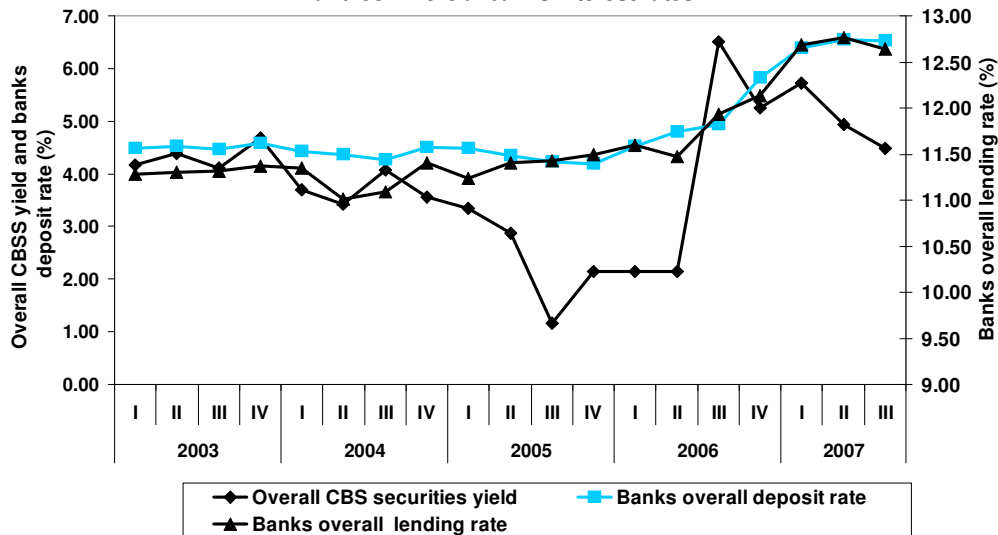
Total commercial bank liquidity (comprising of holdings of CBS securities, excess reserves and cash holdings) continued to expand, with a further 8 percent increase to \$50.3 million, following a slight improvement in the previous quarter. Commercial banks' holdings of CBS securities increased further to total \$15.9 million at the end of the quarter while their excess reserves fell 6 percent to \$24.1 million, a level that was in line with the current stance of monetary policy. Despite this decline, excess reserves of commercial banks were comfortably higher than the preferred minimum level of \$15 million. (See Graph 3.)

Graph 3 : Commercial Banks Total Liquidity



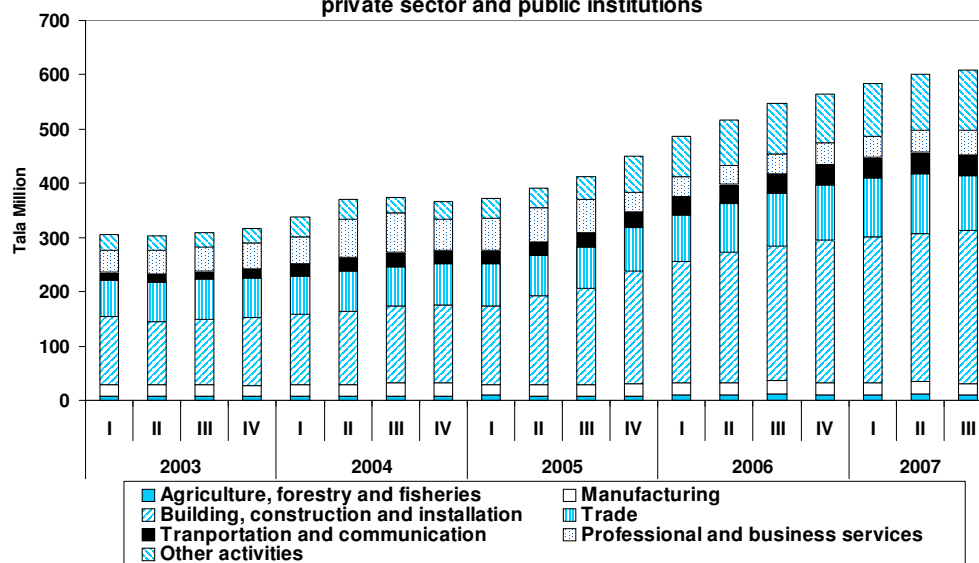
The continued improvement in the overall liquidity position of the commercial banks saw the weighted average official interest rate ease further to 4.48 percent at end September 2007 from 4.94 percent at the end of the previous quarter. Commercial banks' interest rates, likewise, slipped during the quarter, with the weighted average deposit and lending rates declining 2 points to 6.52 percent and 12 points to 12.64 percent respectively. In the event, the commercial banks' interest rate spread narrowed to 6.12 percent from 6.22 percent in the previous quarter. (See Graph 4.)

Graph 4 : Overall yield on CBS securities and commercial banks interest rates



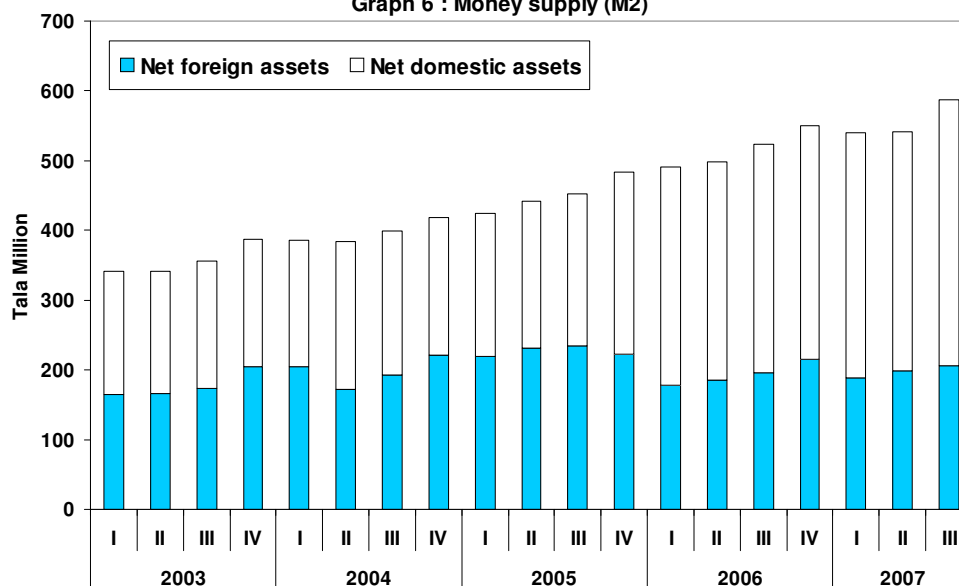
Bank lending to the private sector and public institutions combined strengthened by \$7.8 million to \$608.1 million, assisted by the reduced weighted average lending rate. In particular, loans to the private sector expanded by \$8.6 million to \$553.9 million, with the “building, construction and installation”, “trade” and “other activities” sectors maintaining their dominance over total credit allocation. On an annual average basis, however, the growth of credit decelerated to 19 percent at end September 2007 from 24 percent at end June 2007 and 28 percent at end September 2006; a trend that was much in line with the tight monetary policy stance of the Central Bank. (See Graph 5.)

Graph 5 : Commercial banks credit to the private sector and public institutions



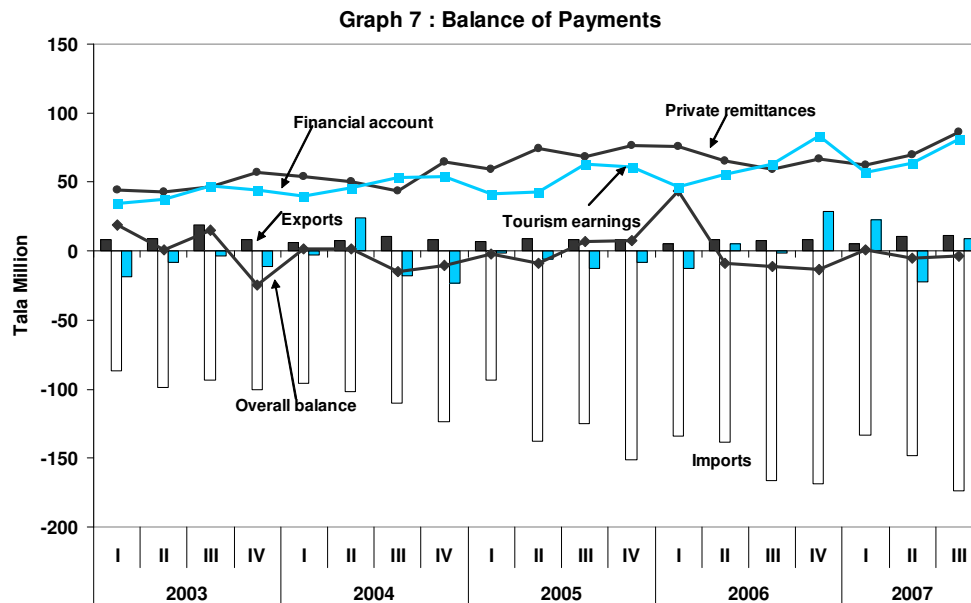
The higher level of bank credit, combined with the substantial decline in net deposits of Government raised the level of net domestic assets by \$38.3 million to \$390.0 million in the September 2007 quarter. Net foreign assets similarly rose \$6.7 million, increasing total money supply (M2) to \$586.9 million. (See Graph 6.)

Graph 6 : Money supply (M2)



On the external sector, the balance of payments recorded an overall surplus of \$3.9 million in the September 2007 quarter, compliments of a significant fall in the current account deficit which reflected the continued expansion in tourism earnings and private remittances and some improvements in export proceeds. (See Graph 7.) Foreign exchange earnings from tourism in the quarter under review surged 27 percent (\$17.2 million) to \$81.0 million. Contributing to this exceptionally high level of tourism earnings was a 17 percent jump in arrivals, reflecting the influx of sportspeople for the 13th South Pacific Games plus an 8 percent expansion in the average tourist expenditure. The majority of tourists that visited Samoa in the third quarter of 2007 were from New Zealand (41 percent) followed by 'Other Countries' and American Samoa with 17

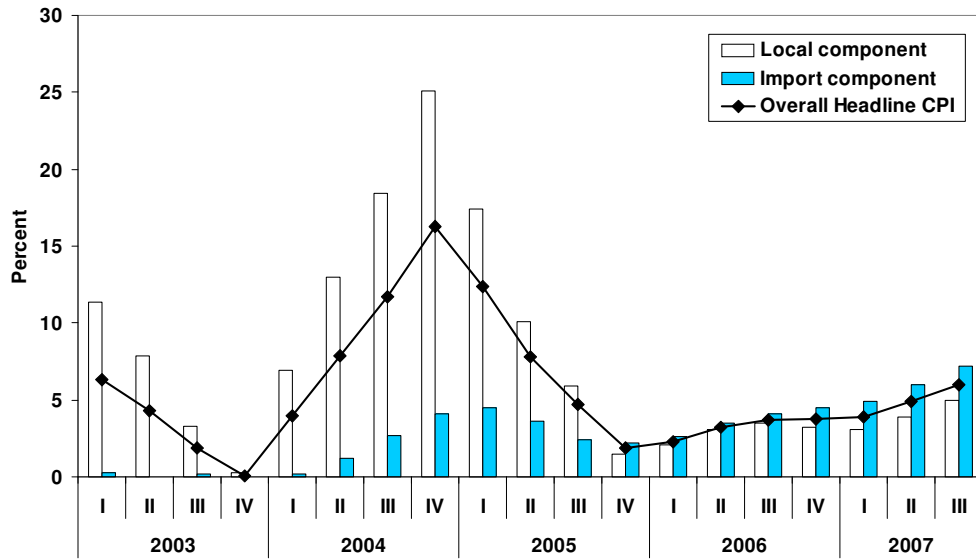
percent each and Australia (16 percent). The surge in the share of 'Other Countries' from 9 percent in the preceding quarter also reflected the arrival of athletes and officials from other South Pacific island countries for the Games. Consequently, visitors who were here for sports accounted for 15 percent of total arrivals, up from only 2 percent in the previous quarter and was the third largest group during the quarter. Most of the tourists were the holidaymakers (40 percent) followed by the business group (27 percent). Private remittances similarly jumped 24 percent (\$16.1 million) due to a 49 percent surge in remittances for charitable organizations and a 16 percent inflow for private households.



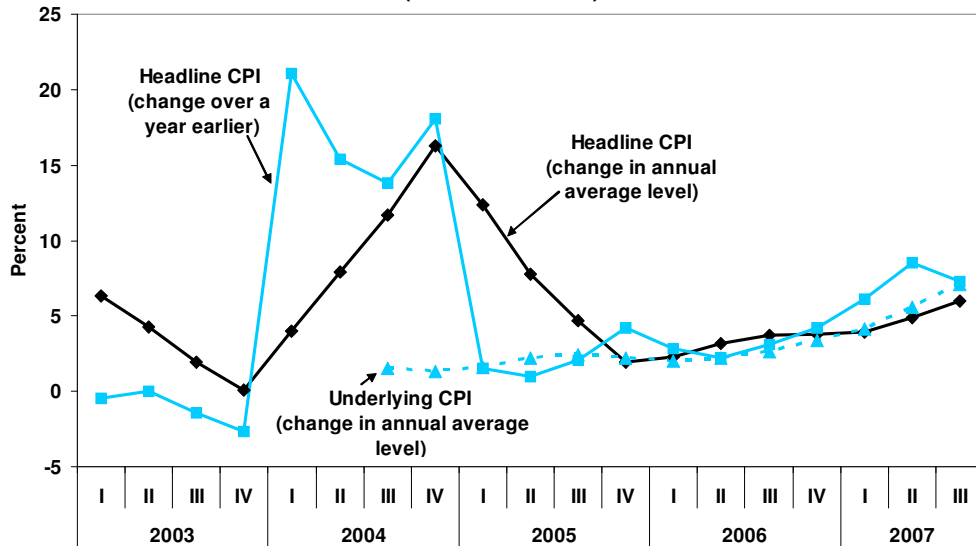
Exports likewise strengthened by a further 8 percent to \$11.2 million, with significant earnings from fish, nonu fruit and handicrafts largely accounted for this improvement. Imports were also stronger, as private sector imports jumped 19 percent, largely reflecting the strong rise in consumable goods that were specifically for the South Pacific Games. As a result, the merchandise trade deficit widened 18 percent to \$162.3 million.

On prices, the average level of consumer prices edged down 0.2 percent in the September quarter of 2007, but it was 7.3 percent higher than in the same quarter a year earlier. (See Graph 8a.) On an annual average basis, therefore, the 'headline' inflation rate increased to 6.0 percent at end September 2007 from 4.9 percent at end June 2007. This rise was due mainly to a 1.7 percent expansion in the 'Transport and Communications' sub-index reflecting rising global oil prices. Higher prices were also recorded in the 'Housing and household operations', 'Alcohol and Tobacco' and the 'Miscellaneous' sub-indices reflecting associated demand pressures during the South Pacific Games period. Similarly, the underlying rate of inflation accelerated to 7.1 percent from 5.6 percent at end June 2007 and 2.6 percent at end September 2006. The higher headline and underlying inflation rates largely reflected strong demand pressures associated with the growing economy and particularly the hosting of the 13th South Pacific Games during the quarter under review. (See Graph 8b.)

Graph 8a : Headline Consumer Price Index



Graph 8b : Consumer Price Index
(March 2004 = 100)



III. PRUDENTIAL SUPERVISION

For the quarter ended 30 September 2007, the banking system continued to grow in terms of total assets against the upward trend in liabilities. And, whilst maintaining an adequate level of capital comfortably above the Central Bank's minimum requirement of 15.0 percent, the overall liquidity level has shown an improvement over the previous quarter.

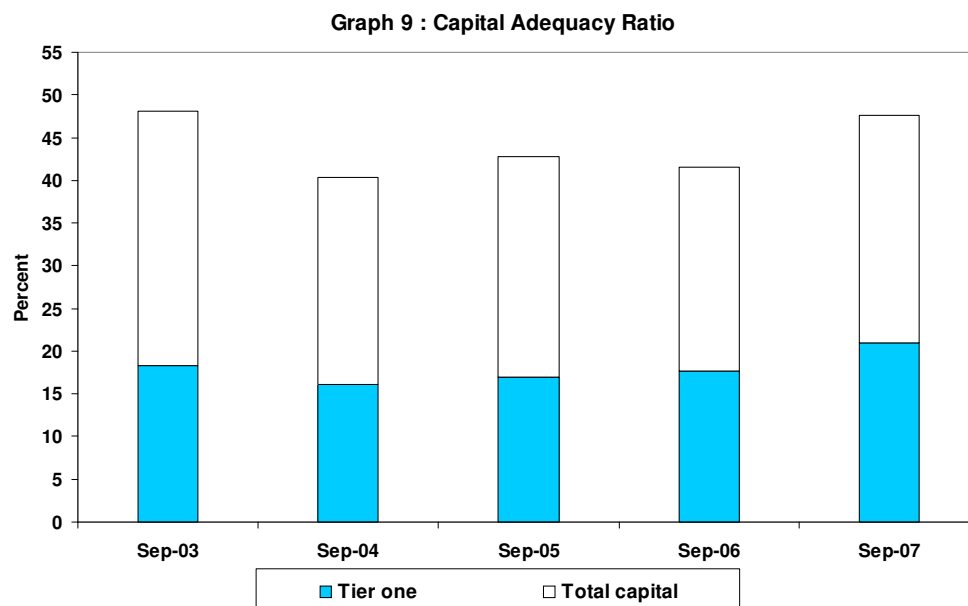
At \$800.8 million, the commercial banks combined assets reflected an increase of 3.6 percent (\$27.5 million) in the September quarter and indicated an annual growth of 14.3 percent (\$100.1 million) when compared to the same time a year earlier. The composition of the commercial banks assets comprised mainly of loans and advances of \$629.2 million (78.6 percent of total assets), cash reserves and deposits with the Central Bank and other banks combined at \$128.4 million (16.0 percent) and fixed assets of \$48.6 million (6.1 percent) respectively.

Total loans and advances of \$629.2 million increased by 2.4 percent (\$14.7 million) at the end of the quarter and further increase by 11.8 percent (\$66.3 million) over the same time a year earlier. The strong growth in loans and advances was attributed mainly to loans to private businesses, households and Government.

Total deposit liabilities showed an increase of 3.1 percent (\$18.1 million) over the previous quarter, with an annual growth rate of 11.5 percent (\$62.5 million). Time deposits (\$352.2 million) represented 58.3 percent of total deposits, demand deposits (\$174.2 million) accounted for 28.8 percent while savings deposits (\$77.5 million) made up 12.8 percent.

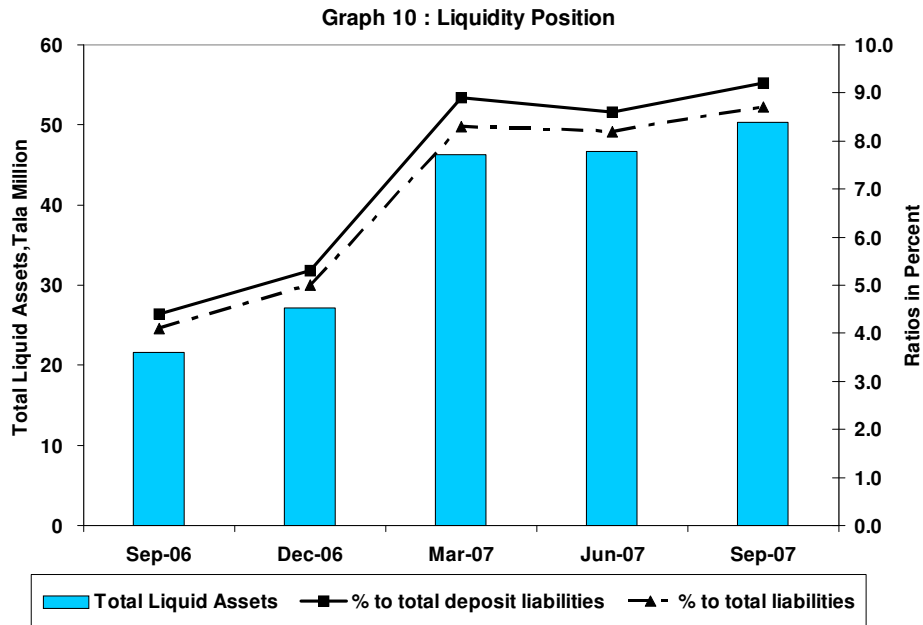
Total contingent and off-balance sheet items decreased by 12.6 percent (\$13.3 million) to \$92.3 million over the previous quarter, due mainly to decreases in unused credit commitments, unmatured foreign exchange contracts, direct credit substitutes and transaction related items.

The banking system remained strongly capitalized at \$146.1 million, revealing an increase of 5.4 percent (\$7.4 million) over the previous quarter due mainly to the banks profitable performance throughout the period. In relation to the overall level of risk weighted assets, the capital adequacy ratio was slightly up from 24.8 percent to 26.6 percent. Tier 1 capital of 21.0 percent increased by 0.3 percent over the June 2007 quarter. (See Graph 9.)



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

The banking system also revealed an improvement in the level of liquid assets by 7.8 percent (\$3.7 million) over the previous quarter and showing an increase of 132.6 percent (\$28.7 million) when compared to the past twelve months level. Total liquid assets stood at \$50.3 million, equivalent to 9.2 percent of total domestic deposit liabilities. Holdings of Central Bank Securities of \$15.9 million made up 31.7 percent of total liquid assets of the banking system at the end of the quarter. (See Graph 10)

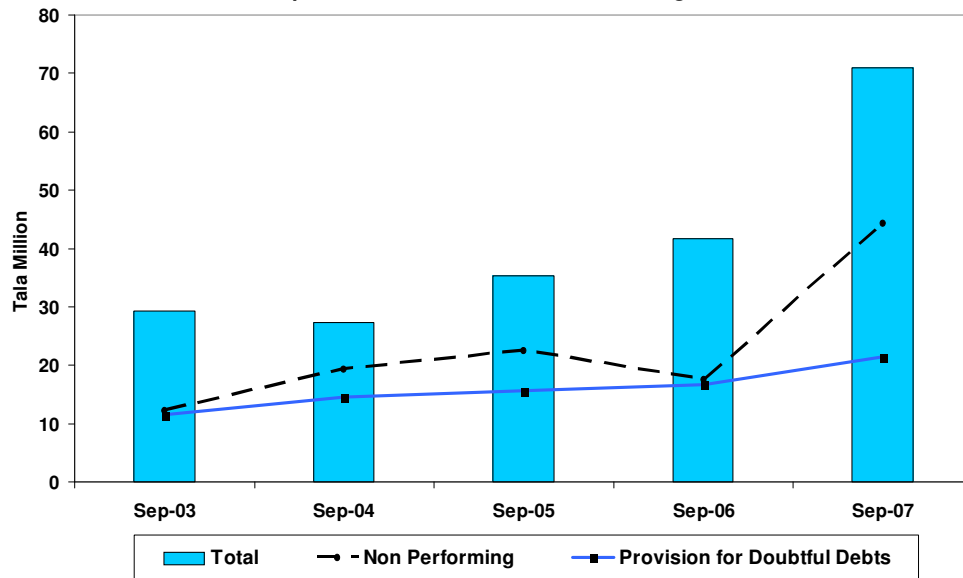


The combined foreign assets of the commercial banks amounted to \$85.2 million as compared to total foreign liabilities of \$85.8 million. At these levels, it showed a net short exposure position of around \$3.3 million or 2.3 percent of total capital.

Total non-performing loans, however, deteriorated further with an increase of 14.9 percent (\$5.8 million) in problem loans now reaching \$44.4 million. As compared to the prior year, non performing loans increased by \$26.7 million. In relation thereto, total provision for bad and doubtful debts of \$21.5 million provides a 48.5 percent buffer against possible loan losses that may derive from non-performing loans. As a proportion of total loans and advances, total provision stood at 3.4 percent respectively.

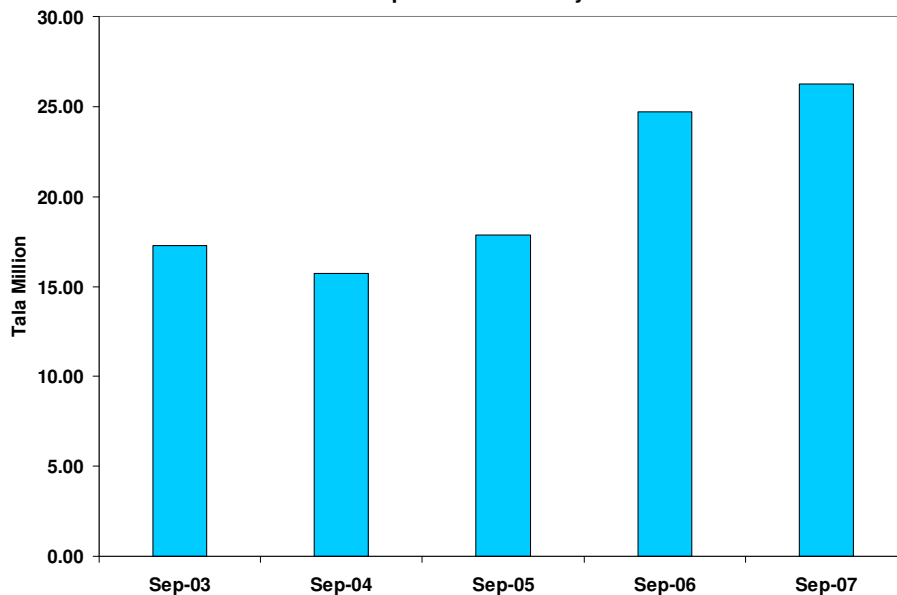
The Central Bank continues to monitor closely the banking system's performance towards reducing the levels of arrearages and non-performing loans, requiring the system to be extra vigilant in its approach towards asset quality. Equally important, is the need for the banks to ensure that adequate provisions are being provided to cover for such problem loans while recovery efforts are pursued. (See Graph 11.)

Graph 11: Past Due and Non - Performing Loans



At a combined figure of \$37.1 million, the banking system’s pre tax profit level increased by 10.7 percent in the quarter under review when compared to the same period a year earlier. Total net profit after tax amounted to \$26.2 million, up from \$24.7 million recorded a year earlier. At this level, return on average network and assets stood at 20.1 percent and 3.5 percent respectively. (See Graph 12.)

Graph 12 : Profitability



For the period under review, total operating expenses represented 63.1 percent of total income, more or less the level achieved in the previous year. Furthermore, the banks continued to achieve good earnings from their non-interest earning activities such as commission, fees and charges and other operating income.

IV. OPENING REMARKS BY THE ACTING GOVERNOR OF THE CENTRAL BANK OF SAMOA, PHILIP H. PENN, AT THE PACIFIC REGIONAL BANKING SUPERVISION SEMINAR, APIA, SAMOA, 23-25 OCTOBER 2007

Mr Andrew Milford, Banking Supervision Advisor from the Pacific Financial Technical Assistance Centre;

Distinguished Resource Persons;

Ms Elizabeth Roberts, Director of the Financial Stability Institute (FSI);

Messrs Graham Johnson and Chris Gaskell from the Australian Prudential Regulatory Authority (APRA);

Mr Kim Norris, Director, International Advisory Group, OSFI, Canada;

Deputy Governors;

Participants;

Ladies and Gentlemen.

As the host for this year's Regional Seminar and the Annual Meeting of the Association of Financial Supervisors of Pacific Countries (AFSPC), I am very pleased and honored, on behalf of the Governor and Staff of the Central Bank of Samoa, to extend to you all a very warm welcome.

We are very happy to see and meet again some familiar faces.

And for those of you who are here on your first visit, a special warm welcome to Samoa and we hope you have time to spare to enjoy the Paradise of the Pacific.

You have certainly arrived at the time when the streets of Apia are back to normal as compared to a few weeks ago when we experienced unusual busy traffic due to the influx of tourists and overseas sports people, who came to enjoy and participate at the 10th South Pacific Games which we hosted last month. With due respect to our friends from the Pacific, I am very pleased to mention that these Games was a great success and an extraordinary achievement for our country and for all those who attended. I understand that some of you were very keen to hold this Seminar to coincide with the Games. But I guess the potential risk from a prudential supervisor's view of loosing participants during the two weeks of the Games may be considered critical and detrimental to achieving the objectives of our Seminar.

That aside, the Central Bank of Samoa is very grateful for the opportunity to be co-hosting this years' event with the Financial Stability Institute in Basel, Switzerland; the Pacific Financial Technical Assistance Centre in Suva; and the Association of Financial Supervisors of Pacific Countries. This Seminar is part of a continuing series of trainings which could only contribute towards enhancing and strengthening our capability as supervisors in the development of our economic and financial systems. This is indeed a great opportunity to learn and share issues of common interest, in particular, the potential risks and threats that could adversely affect the confidence in our banking and financial systems.

As you all know, banks and non-bank financial institutions play a vital role in the economic development of any country. Therefore, there is strong public interest in maintaining the stability and financial soundness of these institutions. And recognizing such importance, central banks have been entrusted with the responsibility of not only licensing but supervising them as well.

The financial system is built on a fundamental (and ever-present) mismatch. Savers want access to their money instantly, if necessary. But borrowers are usually unable to give it to them anything like as quickly.

The banks have traditionally bridged that gap. But the only way they can do so is to borrow short and lend long. This mismatch makes them vulnerable. That is why governments have imposed regulations on the banks, requiring them to hold reserves against emergency. But if there is a complete loss of confidence among depositors, there is really not much an individual bank can do. The central bank is usually obliged to help.

Modern innovations in the financial system have seen banks, rather than holding on to the loans that they have made, parcelled them up and sold them on. The aim was to disperse risk; in the case of default, it was better for a lot of investors to lose a little than for a few banks to lose a lot. However, all the clever types of “securitization and structured products” have not eliminated the fundamental mismatch. Someone still has to borrow short and lend long. Northern Rock, the stricken British bank in recent weeks, is a case in point.

In relation to this case, I just want to paraphrase an interesting article in the latest publication of The Economist headed “*A generation has prospered from the wholesale transfer of risk through securitization. Now it is paying the price*”

[The chief executive of Northern Rock, Mr Adam Applegarth, in unveiling his bank’s first-half results last July, announced that “the medium-term outlook for the company is very positive,” He spoke of a credit book that was “robust”. But, who would have guessed that less than two months later, Britain’s fifth-largest mortgage lender would be fighting for its life, its branches besieged by customers demanding their savings back?

The run on Northern Rock is the most dramatic symptom of the contagion gripping the financial markets. Here was a bank that had grown rich from the innovations of recent years, using abundantly stocked wholesale markets to fund its lively growth, using those same markets to offload bits of its loan book as and when they became unattractive.

But the very innovations on which Northern Rock thrived have savaged its business. The company does no lending overseas. Nevertheless, its fate was determined by the distant turmoil in America’s mortgage market. When that spilled over into the securities markets, the money markets that Northern Rock had depended on for years, dried up in a single day at the start of last August.

The brave new world that enabled banks like Northern Rock to grow so fast is founded on “securitization” – the process that transform mortgages, credit-card receivables and other financial assets into marketable securities – and the innovation it spawned in “structured” products. This was a revolution that brought huge gains. But across the financial world, investors and regulators are asking themselves whether it also brought costs that are only now becoming clear.”

The way oversight of the financial system is split between the FSA, the Treasury and the Bank of England is in doubt. Gordon Brown’s reform of a decade ago means that those responsible for monitoring the banking system are separate from those who make the decision to intervene.]

In understanding the factors that impinge on this particular case about *Northern Rock*, one will learn that the roles and tasks faced by the supervisors and the regulators are enormous. Supervisors need to keep a step ahead of financial market developments and innovations.

We must not be oblivious or ignorant to the fact that, despite all the strength of legal framework, regulatory and supervisory arrangements we can have, we always learn that banks still fail, even those too big to fail collapsed at their own demise – some due to reasons other than risks. In other words, the supervision of banks cannot full or complete guarantee against banking failures.

However, supervision can assist the banks in managing their risks by taking appropriate measures and precautions. After all, banks are vulnerable to errors in human judgment and the fragile confidence of depositors. *Therefore, regulation and supervision is not a substitute for good management.* That is the lesson we have to learn from many bank failures even in countries with the best regulatory systems. Finally, it is the responsibility of the management of the banks themselves to introduce proper checks and balances to ensure that the risks are managed efficiently and effectively.

As we know, the whole approach to bank supervision in particular and financial supervision in general is still in its early evolutionary stage. With the fast changes in financial markets and information technology, the methods of ensuring the safety of banks will also need to change. Already, the rules relating to bank operations are changing in many parts of the world. This means that the ways banks are supervised also need to be changed. The responses to these rapid changes may be slow, but there is concerted and dynamic effort by the international supervisory authorities to ensure the safety of banks.

Thus, banking supervision is conducted in the interest of everyone because the cost of a banking crisis can be enormous. When banks fail, we all fail. And certainly, the cost of a banking crisis will be unbearable especially for our relatively small economies in the Pacific Region.

I note that you have a full agenda ahead of you. At the same time, I have no doubt that the choice of topics is to provide discussions, which should add value to your work not only in your own countries but also for the Pacific region. The case study that will provide the experience of Palau regarding the failure of one of its biggest bank, will not only remind us of the reality and the crucial role of bank supervisors, but it should bring us together to learn from it and be better prepared for the possibility of such crisis occurring in our own respective countries.

I also note with interest that you will be covering the Basel *Revised* Core Principles which, as I mentioned earlier, reflect the ever changing environment in which banks operate, that international standards continue to change as the environment of risks also changes. And as part of the global financial system, we all need, to some extent, to adapt to such changes. Although some of these changes may not directly affect us due to our narrow market base, others can impact on our financial system indirectly. One of these changes would be the Basel II new capital adequacy framework that has already been advanced for some years for adoption.

From experience, the new Capital Accord will have significant impact on our limited resources and our capacity to administer and properly implement. In this connection, I am pleased to acknowledge the presence of resource experts, Ms Elizabeth Roberts, Director of the Financial Stability Institute (FSI) at the Bank for International Settlements, Basel; Messrs Graham Johnson and Chris Gaskell from the Australian Prudential Regulatory Authority (APRA); Mr Kim Norris, Director, International Advisory Group, OSFI, Canada; and experts from the IFC. I am confident that their knowledge and experience would be immensely helpful to the participants in understanding and appreciating the practical implications behind these changes both from a supervisor's perspective as well as from the standpoint of the supervised institutions.

To conclude, let me say that we all face enormous resource and capacity constraints in coping with existing responsibilities, let alone undertaking these new challenges. Hence, the value of coming together to share our experiences and plan regional training programs for our member

countries is very important. Through these meetings, we can learn and maintain strong networking relationship which should enhance our efforts in capacity building in this innovative and challenging area of financial supervision.

Ladies and gentlemen, it gives me much pleasure to declare this Regional Seminar for Financial Supervisors open and I wish you all an enjoyable and fruitful week of discussions.

Thank you for your attention and may God Bless you all.

Soifua.
