

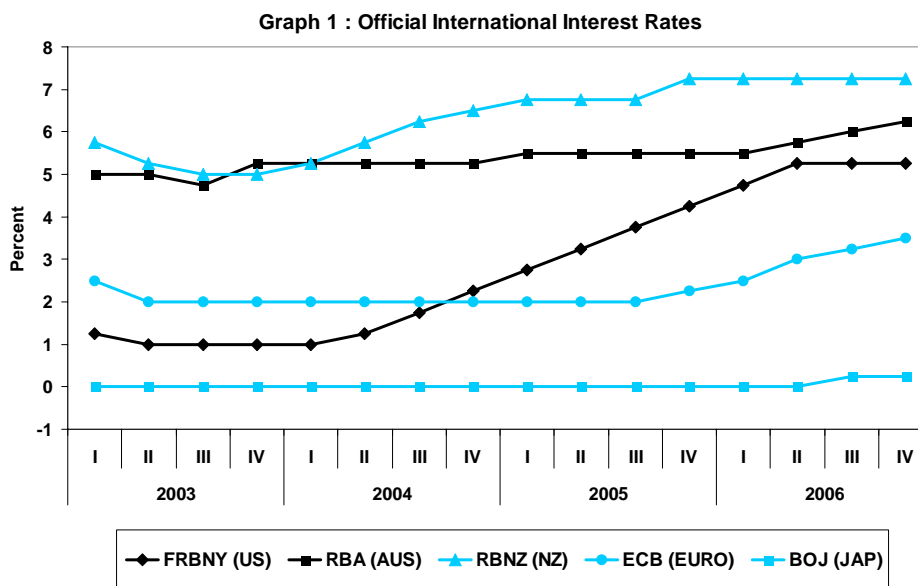
II. OVERVIEW OF ECONOMIC DEVELOPMENTS DURING THE FOURTH QUARTER OF 2006.

a. The World Economy

The world economy continued to expand at a strong pace in the December quarter of 2006. The US economy remained robust despite the slowdown in the housing sector. Other parts of the world remained consistent with expectations of strong growth. In Japan, improved conditions in the business sector and the labour market pointed to further expansion. In the euro area, a moderate pace of expansion still continued.

The US economy's real GDP increased by 0.9 percent in the December quarter of 2006, to be 3.4 percent over the year. Strong consumption and exports drove growth in the quarter under review. The softening of conditions in the housing market weakened consumer spending and eased growth in households' wealth. Manufacturing production dropped in the December quarter due to the softness in construction related sectors. However, production was stronger and business confidence was positive. The unemployment rate continued to fall, to be at a five-year low of 4.6 percent in the December quarter. CPI inflation dropped since the middle of 2006 largely due to lower oil prices and core inflation also dropped to an annualized 2.6 percent in the December quarter.

In its two meetings in the December quarter, the US Federal Open Market Committee (FOMC) continued to keep the Fed funds interest rate unchanged at 5.25 percent due to slow economic growth over the year, reflecting a substantial cooling of the housing market. While recent indicators have been mixed, the Federal Reserve noted that the economy seemed likely to expand at a moderate pace over coming quarters. (See Graph 1.)



While the cycle of expansion in the Australian economy has been long, it is now characterised by modest rather than spectacular growth. This was due to the effect of drought on the farm sector which weighed on the economy as a whole. The economy's seasonally adjusted GDP grew by 1.0 percent in the December quarter of 2006, to be 2.8 percent over the year. Retail sales, on the other hand, rose by 0.9 percent in October and 0.2 percent in November, producing an annual rate of 6.7 percent. Spending had been supported by solid growth in household incomes on the back of strong employment gains and solid increases in wages. The unemployment rate remained at a 30 year

low of 4.6 percent. Consumer prices in underlying terms increased by 0.5 percent in the December quarter and by 3 percent over the year.

In the 2006 December quarter, the Reserve Bank of Australia increased interest rates by 25 basis points, to 6.25 percent. The Board's decision was taken against a background of continued expansion in the global economy and further evidence that inflationary pressures had increased.

Domestic demand growth in New Zealand weakened during 2006 in response to higher interest rates. However, consumer sentiment increased strongly in the December quarter buoyed by lower petrol prices, renewed strength in the housing market and favourable labour market conditions. Inflation data for the December quarter showed a 0.2 percent fall in the Consumers Price Index (CPI), with annual inflation falling to 2.6 percent and non-tradable inflation falling below 4 percent for the first time in a number of years.

In its two meetings in the December quarter, the Reserve Bank of New Zealand decided to hold its official cash rate at 7.25 percent as recent economic activity has been weaker and continued to show signs of easing.

The expansion in the euro area continued, despite moderate growth at the end of 2006. However, external demand provided a boost to growth, with exports increased by 12 percent over the year to November. The unemployment rate declined to 7.5 percent in the December from a peak of 8.9 percent in mid 2004. While there were signs of improvement in the household sector as well, retail sales growth slowed from 0.5 percent to 0.3 percent in the December quarter.

The European Central Bank (ECB) in its two December quarter interest rate reviews added 0.25 percent on separate occasions, raising interest rates from 3.0 percent to 3.25 in October and to 3.50 percent in December. Economic growth in the euro area has strengthened, and the ECB continued to see some upside risks to the inflation outlook.

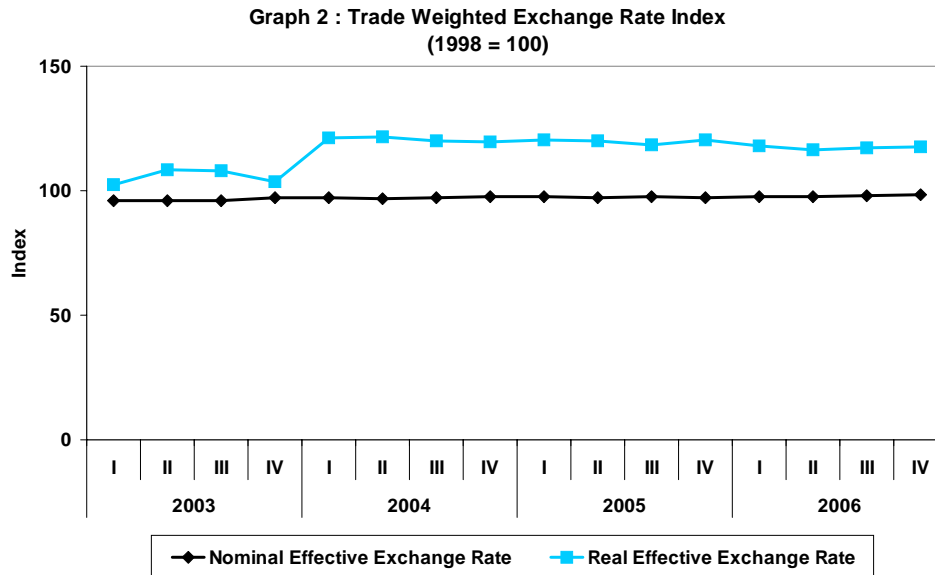
Growth in the United Kingdom continued to pick up steam, with the economy expanding by 0.8 percent in the December quarter to be 3.0 percent over the year. This was due to a booming services sector which had offset a slowdown in manufacturing and a sharp drop in utilities output. The unemployment rate in the UK increased in 2006, reaching 5.5 percent, due to an increased influx of migrant labour over recent years. There were signs however, that the unemployment rate has stabilised.

With inflation pressures building up in recent months, the Bank of England decided to raise its official cash rate by 0.25 percent to 5.00 from 4.75 percent in the December quarter. The Monetary Policy Committee concluded that the raise was necessary to bring CPI inflation back to the target in the medium term.

Conditions remained supportive of continued growth in Japan in 2006. Industrial production rose by 4.9 percent over the year to November and inventories up by 3 percent, after declining in the previous quarter. Manufacturing production and exports continued to expand, and the December quarter Tankan survey showed that capacity was stretched in many sectors of the economy that firms continued to revise up their near-term investment intentions. Following its December quarter meeting, the Bank of Japan continued to hold short-term interest rate at 0.25 percent as the operating target for monetary policy.

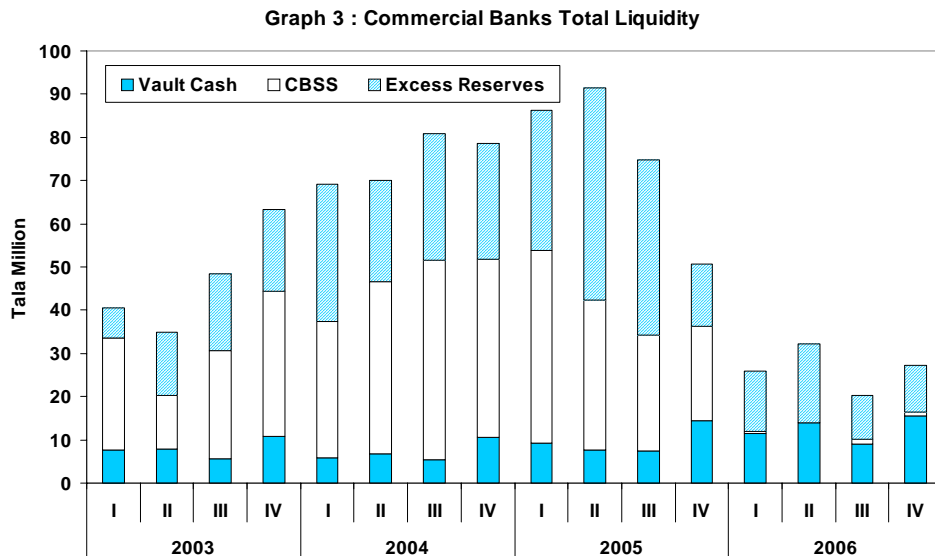
During the quarter under review, the US dollar continued to depreciate against most major currencies, with the exception of the Yen. This was due to the fact that US monetary policy has been held steady since June while European interest rates have continued to rise. Against the currencies of Samoa's major trading partners, the Tala depreciated against all the currencies in the

basket with the exception of the US dollar. The value of the Tala in terms of its nominal index showed an appreciation of 0.43 percent in the fourth quarter of 2006. And, with price rises in Samoa being higher than the price increases of her major trading partners, the real effective exchange rate of the Tala rose 0.55 percent.



b. The Samoan Economy

Monetary conditions in the fourth quarter of 2006, remained tight although total commercial bank liquidity improved slightly, assisted by a reduction in the Statutory Reserve Deposit (SRD) ratio from 4.8 percent to 3.5 percent in October 2006 and a net inflow of foreign exchange in December 2006. Total commercial bank liquidity (comprised of holdings of CBS securities, excess reserves and cash holdings) recovered 34 percent to \$27.2 million after dropping in the previous quarter to \$20.2 million, its lowest end-of-quarter level since the introduction of financial liberalization in January 1998. (See Graph 3.)

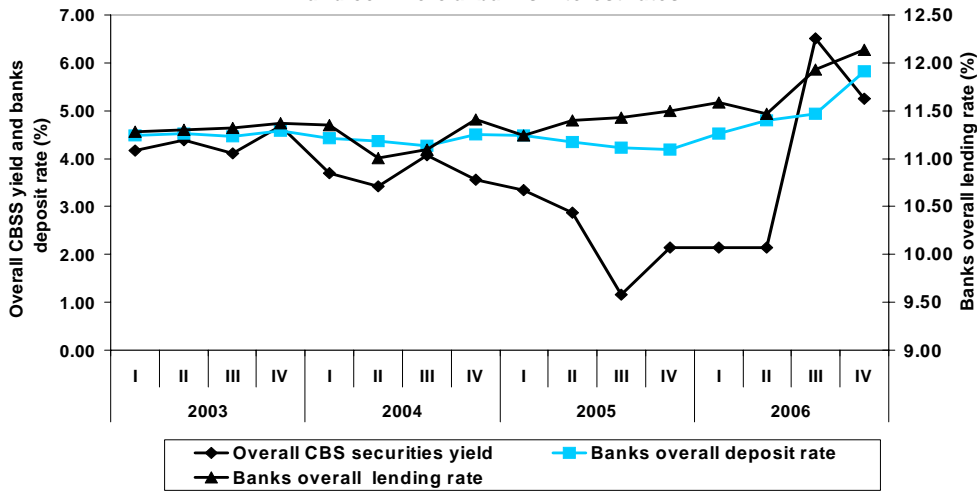


The Government’s financial operations in the December 2006 quarter registered a quarterly cash surplus of \$3.1 million vis-à-vis the monetary system, thus assisting in maintaining the tight stance adopted by monetary policy. In fact, Government’s financial position vis-à-vis the

monetary system in the previous three consecutive quarters was in surplus, easing some of the pressure on monetary policy.

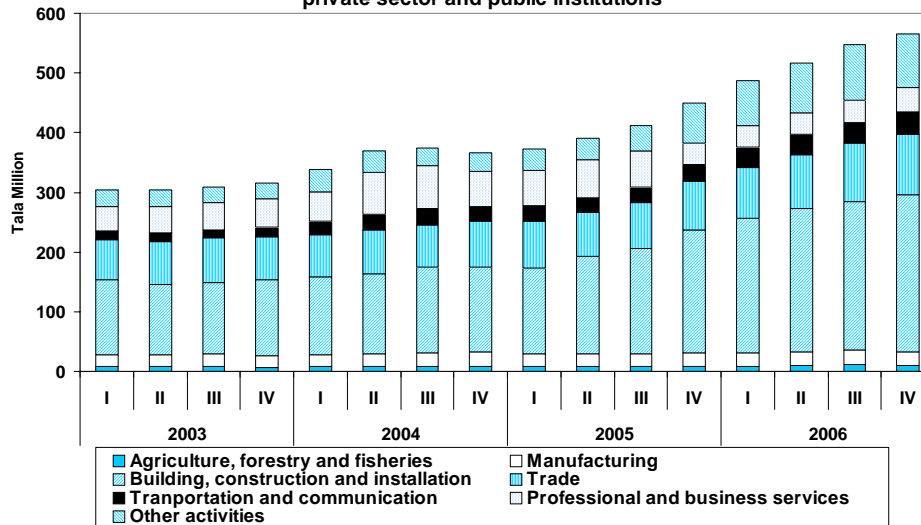
A slight improvement in the overall liquidity position of the commercial bank, particularly in the last few weeks of December 2006, saw the weighted average official interest rate ease to 5.25 percent at end December 2006 from 6.50 percent at the end of the previous quarter. Apart from the large inflow of foreign funds and reduction of the SRD ratio, the improved liquidity position of the banks also reflected an improvement in private sector deposits following an increase in the banks' weighted average deposit rate. The weighted average deposit rate jumped 53 points to 5.41 percent. On the credit side, the average lending rate rose 35 points to 12.07 percent on top of a 20 points rise in the previous quarter. In the event, the commercial bank's interest rate spread narrowed to 6.66 percent from 6.84 percent in the previous quarter. (See Graph 4.)

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

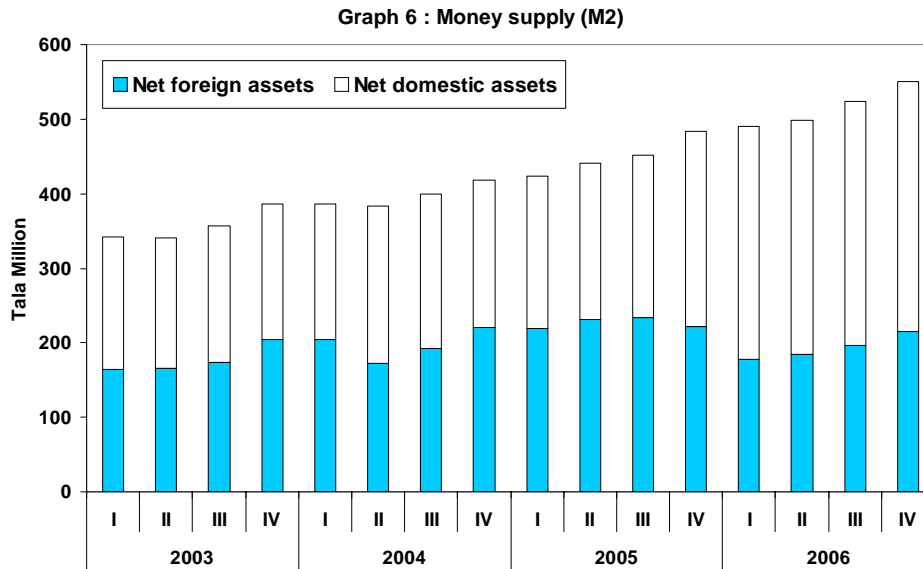


Despite the increased lending rates, strong demand for credit by the private sector and Government corporations saw bank credit to the private sector and public institutions combined increase by \$23.4 million to \$567.89 million, slightly lower than a \$25.1 million hike in the previous quarter. Loans to the 'Building and construction' sector grew \$14.8 million to \$263.8 million on top of a \$7.6 million rise in the September 2006 quarter while those to the 'Trade' and 'Transportation' sectors went up \$4.5 million and \$2.5 million respectively to \$101.5 million and \$34.8 million in that order. (See Graph 5.)

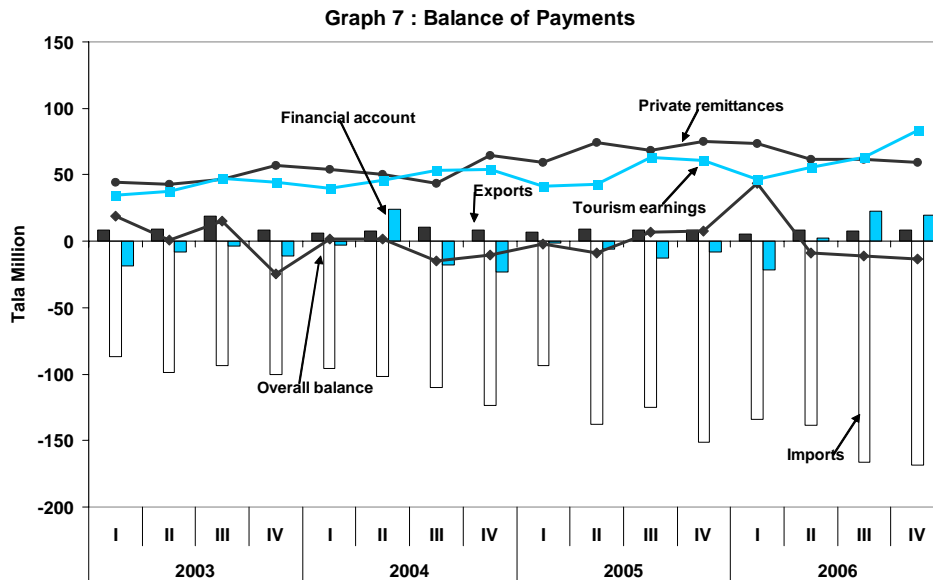
Graph 5 : Commercial banks credit to the private sector and public institutions



A 10 percent increase in net inflows of foreign funds combined with the rise in private sector to boost total money supply (M2) by 5 percent in the December quarter of 2006. (See Graph 6.)



On the balance of payments, a surplus of \$13.5 million was recorded in the December 2006 quarter, compliments of a substantial drop in the current account deficit. (See Graph 7.)

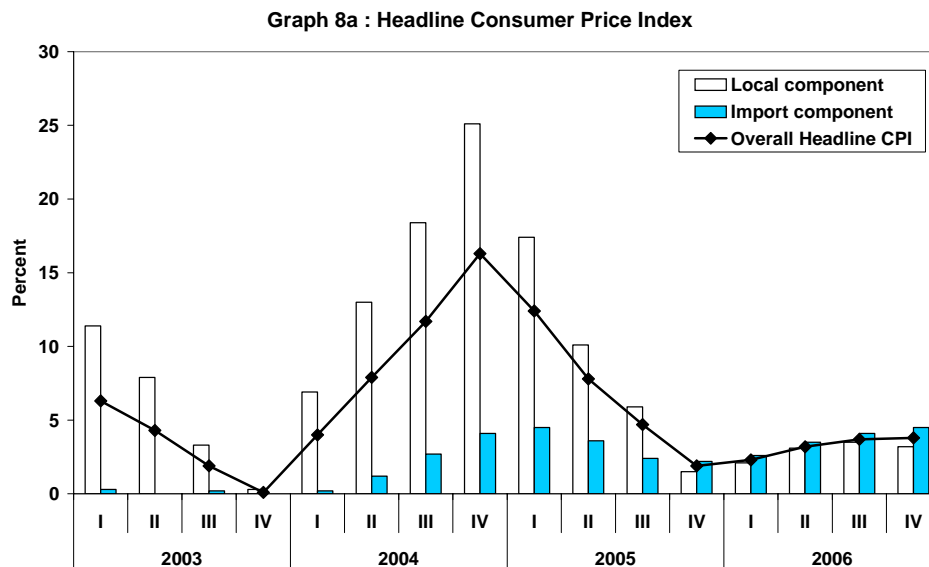


The lower current account deficit reflected the continued success of tourism and increased inflows of private remittances. Foreign exchange earnings in the quarter under review expanded 32 percent or \$20.1 million on account of the usual tourist influx for the end of year festivities which saw a 26 percent rise in tourist arrivals and a 6 percent increase in average tourist expenditure. As usual, the majority of tourists that visited Samoa in the last quarter of 2006 were those from New Zealand (39 percent), American Samoa (22 percent) and Australia (22 percent). Most of the tourists were here to visit friends and relatives (46 percent) and those who were here purely on holiday (33 percent). Private remittances rose 13 percent (\$7.5 million) due to a 20 percent hike in household remittances while remittances for charitable organizations decreased 8 percent.

The merchandise trade deficit, on the other hand, widened 1 percent reflecting a 1 percent (\$2.5 million) growth in imports partially offset by a 6 percent (\$0.5 million) rise in export earnings. Private sector imports rose 6 percent (up \$8.1 million) reflecting a strong increase in consumer goods, particularly imports of prepared foodstuffs. On the other hand, Government imports shrank 51 percent (\$3.6 million) while a 7 percent or \$2.3 million drop was recorded in petroleum imports. Total export earnings rebounded 6 percent (\$451 thousand) in the fourth quarter of 2006 to \$8.04 million mainly due to a substantial increase in re-exports from only \$30 thousand in the third quarter of 2006 to \$0.8 million in the quarter under review. Domestic exports, on the other hand, fell 5 percent or \$0.4 million.

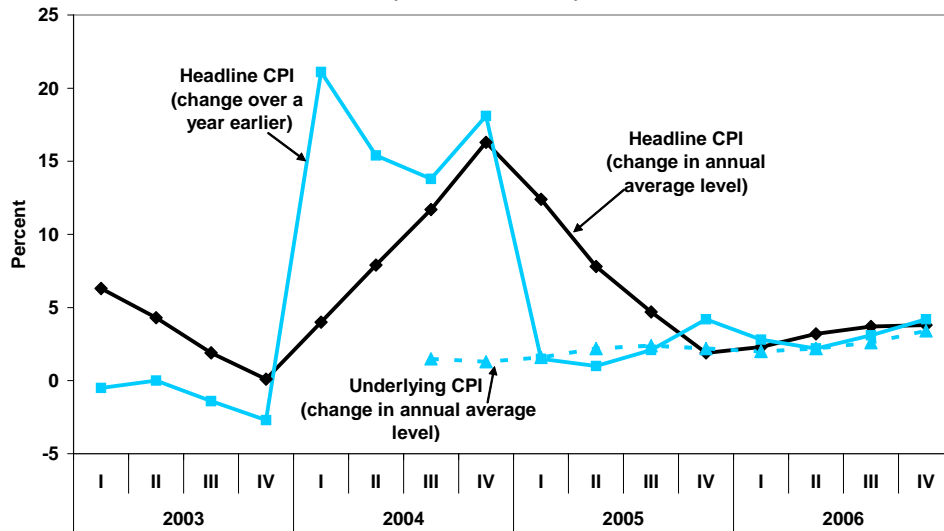
The drop in domestic exports reflected a substantial 32 percent fall in fish export earnings whereas most of the other major export commodities improved in the December 2006 quarter although were not sufficient to offset the decline in fish export revenues. Revenue from beer and nonu juice grew 93 percent and 314 percent respectively to \$1.0 million each, with the substantial recovery in nonu juice exports reflecting the completion of a new and improved manufacturing plant. Coconut cream proceeds also rose 19 percent and that of taro increased 27 percent.

On prices, the average level of headline consumer prices rose 3.3 percent in the December quarter of 2006 to a level 4.2 percent higher than in the same quarter a year earlier. (See Graph 8a.) The increase in the headline Consumer Price Index mainly reflected rises in food prices in view of the wet weather conditions and seasonal hike in demand associated with the usual festivities during the quarter under review. The overall local component, in particular, increased 3.0 percent due to a seasonal rise in local food prices as well as higher costs of alcohol and tobacco in light of the 2.5 percent increase in VAGST during the quarter under review. Similarly, the imported component grew 3.7 percent with increased international prices and VAGST impacting mostly on imported foodstuffs and alcohol products.



The headline rate of inflation, on an annual average basis, edged up to 3.8 percent at end December 2006 from 3.7 percent at end September 2006 and 1.9 percent at end December 2005. (See Graph 8b.) Similarly, the underlying rate of inflation rose to 3.4 percent from 2.6 percent at end September 2006 and 1.3 percent at end December 2005. The increased rates of headline and underlying inflation reflected the adverse impact of strong demand pressures and the increased VAGST.

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



III. PRUDENTIAL SUPERVISION

For the quarter ended 31 December 2006, 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 remained at a relatively low level despite a slight improvement shown over the previous quarter.

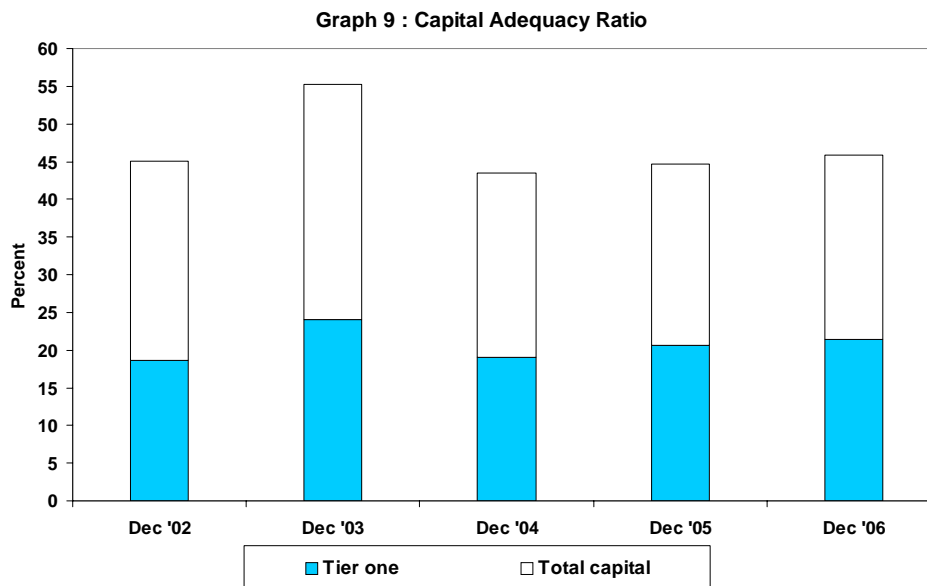
At \$729.6 million, the commercial banks combined assets reflected an increase of 4.4 percent (\$30.6 million) in the December quarter and indicated an annual growth of 17.3 percent (\$107.4 million) when compared to the same time a year earlier. The composition of the commercial banks assets comprised mainly of loans and advances of \$581.2 million (79.7 percent of total assets), cash reserves and deposits with the Central Bank and other banks combined at \$89.3 million (12.2 percent) and fixed assets of \$47.2 million (6.5 percent) respectively.

Total loans and advances increased by 3.3 percent (\$18.3 million) to \$581.2 million at the end of the quarter, a level 28.1 percent (\$127.6 million) higher 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.

There was a gradual increase in deposit liabilities of 3.1 percent (\$16.9 million) over the previous quarter and thus recording an annual growth rate of 13.7 percent (\$67.5 million) respectively. Time deposits (\$314.0 million) represents 56.2 percent of total deposits, demand deposits (\$177.9 million) accounted for 31.9 percent while savings deposits (\$66.4 million) made up 11.9 percent of total deposit liabilities.

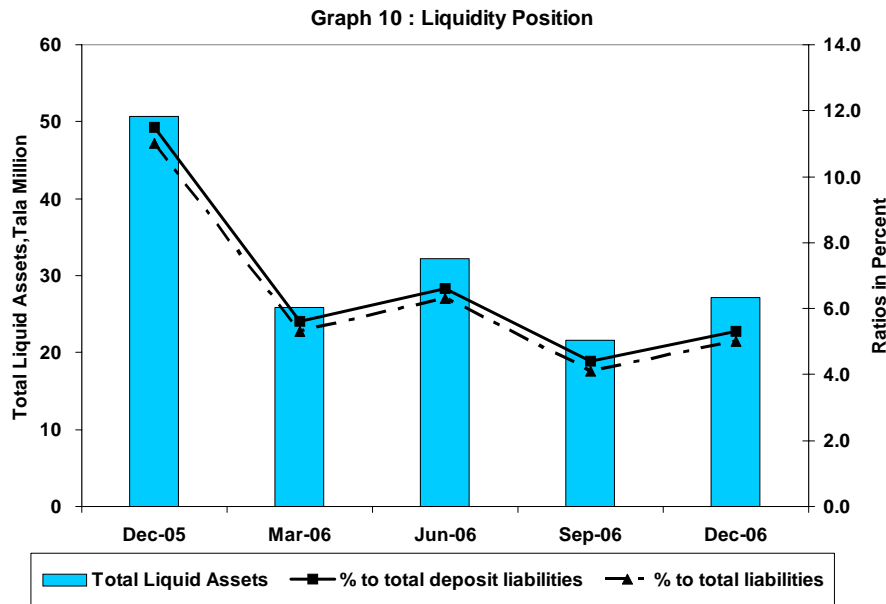
Total contingent and off-balance sheet items increased by 13.7 percent (\$11.8 million) to \$98.0 million over the previous quarter, due mainly to upward movement in unused credit commitments.

The banking system remained strongly capitalized at \$129.6 million, revealing an increase of 6.4 percent (\$7.8 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 edged up from 23.8 percent to 24.4 percent. Tier 1 capital of 21.4 percent increased further by 3.7 percent over the September 2006 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 December quarter.

The banking system also recorded a moderate increase in the level of liquid assets by 25.7 percent (\$5.6 million) over the previous quarter but still well below by 46.3 percent (\$23.5 million) when compared to the past twelve months level. Total liquid assets stood at \$27.2 million, equivalent to 5.3 percent of total domestic deposit liabilities. The Central Bank Securities of \$1.0 million made up 3.6 percent of total liquid assets at the end of the quarter under review. (See Graph 10.)

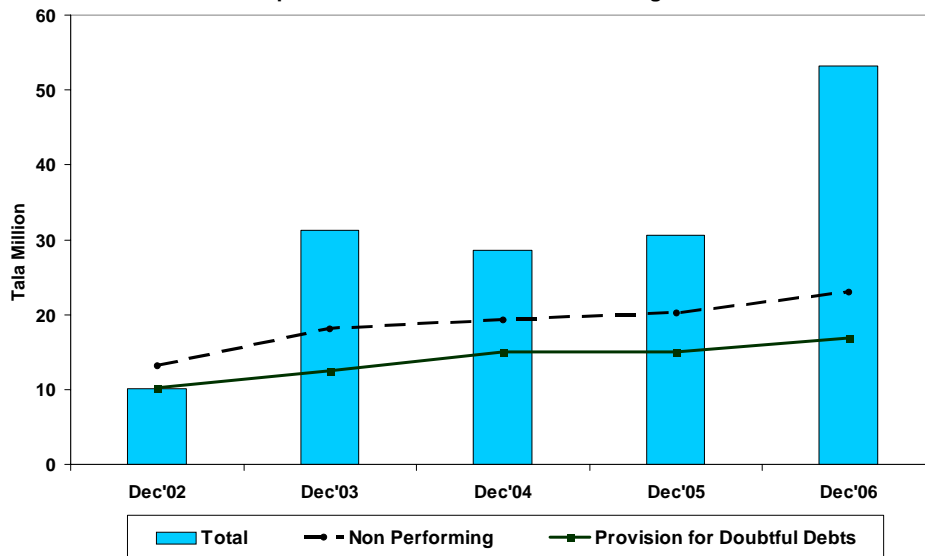


The combined foreign assets of the commercial banks amounted to \$58.6 million as compared to total foreign liabilities of \$56.7 million. At these levels, it showed a net long exposure position of around \$5.6 million or 4.3 percent of total capital.

Total non-performing loans however, deteriorated further with an increase of 30.9 percent (\$5.4 million) in problem loans now reaching \$23.1 million. As compared to the prior year, non performing loans rose by 14.2 percent (\$2.9 million) respectively. In relation thereto, total provision for bad and doubtful debts of \$16.9 million provides a 73.2 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 2.9 percent.

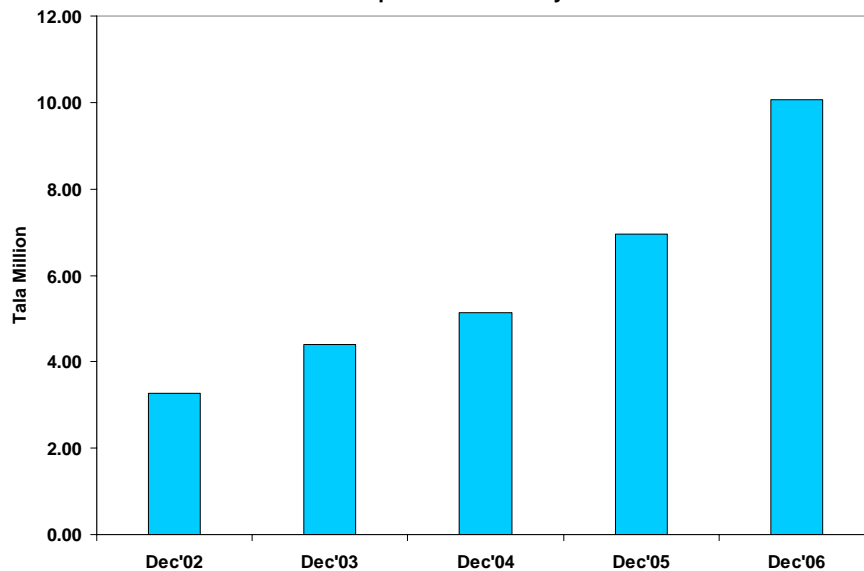
The Central Bank continues to closely monitor the banks performance towards reducing their levels of arrearages and non-performing loans, which require them to be extra vigilant in their approaches towards asset quality. Equally important, is the need for the banks to ensure that adequate provisions 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 \$14.2 million, the banking system’s pre tax profit level increased by 45.8 percent in the quarter under review when compared to the same period a year earlier. Total net profit after tax amounted to \$10.1 million, up markedly from \$9.7 million recorded a year earlier. At this level, return on average network and assets stood at 8.8 percent and 1.5 percent respectively. (See Graph 12.)

Graph 12 : Profitability



For the period under review, total operating expenses represented 66.0 percent of total income, an improved level of efficiency for the banking system when compared to the same time a year earlier. Furthermore, the banks continued to achieve good earnings from their non-interest earning activities such as commission, fees and charges and foreign exchange gains.
