

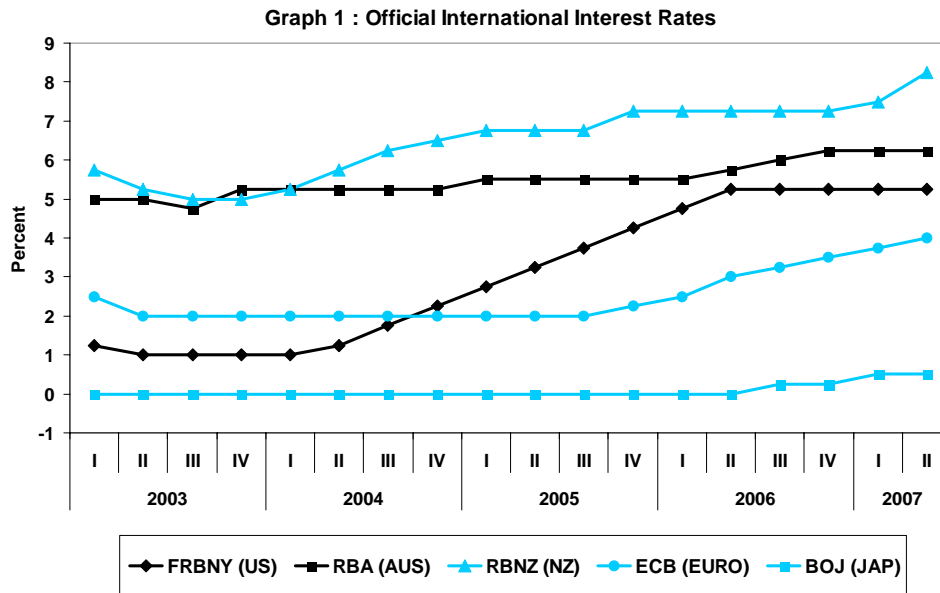
II. OVERVIEW OF ECONOMIC DEVELOPMENTS DURING THE SECOND QUARTER OF 2007.

a. The World Economy

The world economy continued to grow in the June quarter of 2007. The expansion has been broad-based across the countries with firm growth in Europe and Japan. However, weaker growth was expected for the United States, where growth has been below trend for the past year due to ongoing problems in the housing sector.

In the US, real GDP increased by 0.8 per cent in the June quarter to be 1.8 per cent higher over the year, down from around 3 per cent in the previous years. Activity in the US housing market continued to weaken as residential investment fell 2.4 per cent in the June quarter and by 19 per cent 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. Despite this, household consumption remained resilient in the face of the housing downturn. Business investments rose solidly in the June quarter, to be 3.4 per cent higher over the year. CPI inflation picked up a little to be 2.7 per cent over the year to June after slowing down in the second half of 2006. Over the same period, core inflation eased to 2.2 per cent. Core inflation is expected to moderate further as growth in housing costs continue to slow.

In its two meetings in the June quarter, the Federal Open Market Committee (FOMC) continued to keep the Fed funds interest rate unchanged at 5.25 percent. Indicators during the quarter under review have been mixed and the adjustment in the housing sector is ongoing. Nevertheless, the US economy seems likely to continue to moderate over coming quarters.



The Australian economy continued to perform strongly in the second quarter of 2007 driven by domestic demand. Economic data in the June quarter suggest that economic activity remained firm, although GDP growth is likely to be more moderate than reported in the March quarter. Retail sale was broadly flat and sales of motor vehicles increased modestly, employment growth remained solid and survey measures of business conditions have strengthened. The Consumer price index for the June quarter showed an increase of 1.2 per cent and by 2.1 per cent over the year.

In the June quarter, the Reserve Bank of Australia decided to keep interest rates unchanged at 6.25 percent. The Board's decision was based on prices available at the time which suggested that inflation was running at a lower rate than previously expected.

The New Zealand economy is expecting a growth rate in real GDP to remain reasonably strong at around three-quarter per cent in the June quarter. Capacity constraints remained tight in the quarter under review and firms experienced increases in input cost. As a result, profit expectations were down, investment intentions eased and general business confidence fell. However, consumer credit continued to grow reasonably strong in June. Consumer price inflation in the June quarter was above forecast and annual non-tradables inflation remained high, with a resurgence in home building costs. Higher inflation is likely to have led to higher growth in nominal GDP in the June quarter than previously forecast.

In the June quarter, the Reserve Bank of New Zealand raised its official cash rate by a total of 50 basis points to 8.0 per cent, citing concerns about the resurgence in domestic demand, buoyant housing market and government spending.

Economic growth in the euro area remained firm in the second quarter of 2007. The euro area retail sales have been soft in the June quarter, although there were positive signs, with rising consumer sentiment and a further improvement in the labour market conditions. The unemployment rate was 6.9 per cent in June, its lowest level in more than 15 years. Headline inflation in the euro area was in line with the European Central Bank's (ECB) target of below but close to 2.0 per cent.

The ECB in its June quarter reviews hiked interest rate only once by 0.25 basis points to take the ECB rate to 4.0 per cent. The ECB noted that the risks to inflation remained on the upside, owing to high levels of capacity utilisations and tight labour markets.

Growth in the United Kingdom remained firm in the June quarter, with GDP up by 0.8 percent, to be 3.0 per cent higher than a year ago. At the same time, retail sales data for the period under review suggest firm growth in household consumption. Headline inflation eased in June to 2.4 per cent from 2.5 per cent in May due largely to falls in regulated electricity and gas prices.

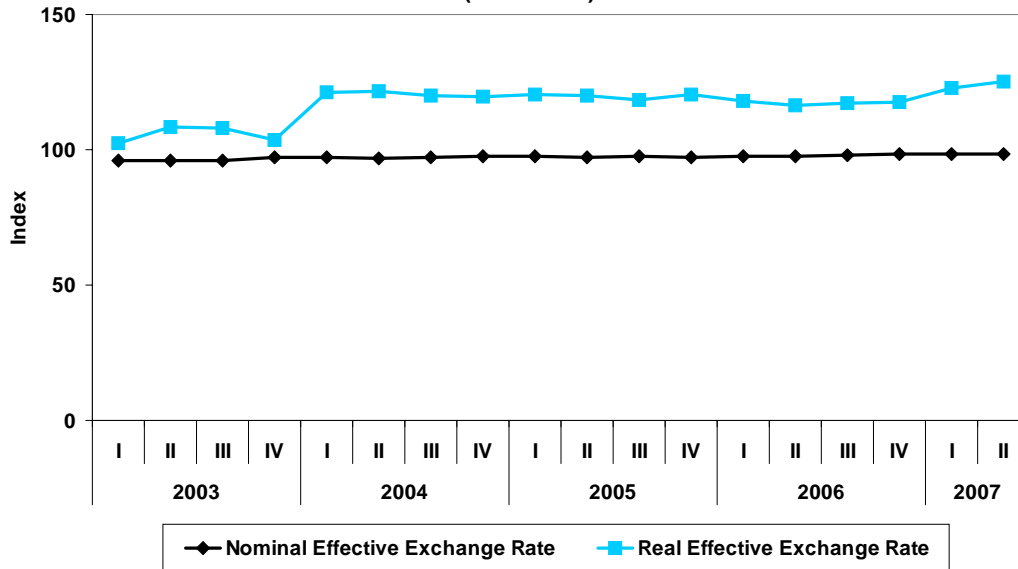
In the June quarter, the Bank of England decided to raise its official cash rate by 0.25 percent to 5.50 per cent from 5.25 percent. The Monetary Policy Committee concluded that capacity utilisation was high and that pricing surveys were pointing to increasing inflationary pressure.

In Japan, economic activity continued to recover steadily in the second quarter of 2007, while inflation remained subdued. The June Tankan survey showed that business conditions remained firm, despite a slight deterioration in small and medium-sized enterprises in the second quarter. At the retail level, CPI inflation has not shown a clear direction, with the core measure (which excludes food and energy prices) gradually picking up over the past couple of years but still remains below zero. During the June quarter meetings, the Bank of Japan decided to leave its target for the uncollateralized overnight call rate unchanged at 0.50 per cent.

During the quarter under review, the US dollar depreciated against most major currencies. The main factor which weighed on the US dollar over the period was due to lower interest rates in the US and a reassessment of growth prospects in the US compared to its trading partners. Against the currencies of our major trading partners, the Tala depreciated against the New Zealand dollar and the Australian dollar but appreciated against the US dollar, Euro and the Fiji dollar. The value of the Tala in terms of its nominal index showed an appreciation of 0.11 per cent in the second quarter of 2007. Furthermore, since price rises in Samoa have been higher than the price rises of

our major trading partners and coupled with the appreciation of the Tala in nominal terms, the real effective exchange rate of the Tala rose 1.84 percent.

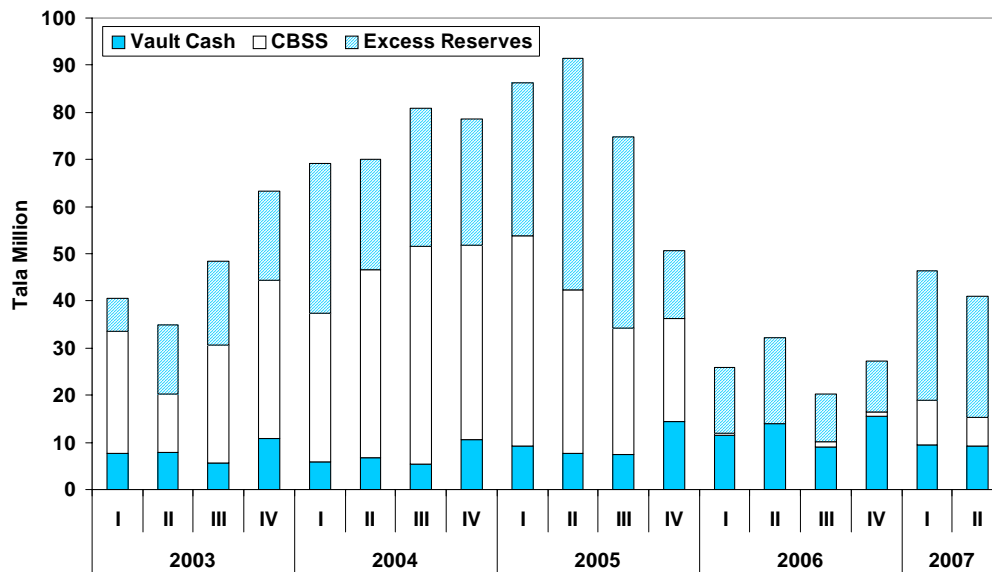
**Graph 2 : Trade Weighted Exchange Rate Index
(1998 = 100)**



b. The Domestic Economy

Monetary conditions in the second quarter of 2007 eased somewhat with a slight improvement in total commercial bank liquidity that was assisted by a net inflow of foreign exchange. Total commercial bank liquidity (comprising of holdings of CBS securities, excess reserves and cash holdings) improved 0.2 percent to \$46.4 million following a substantial \$19.2 million recovery in the previous quarter. (See Graph 3.)

Graph 3 : Commercial Banks Total Liquidity

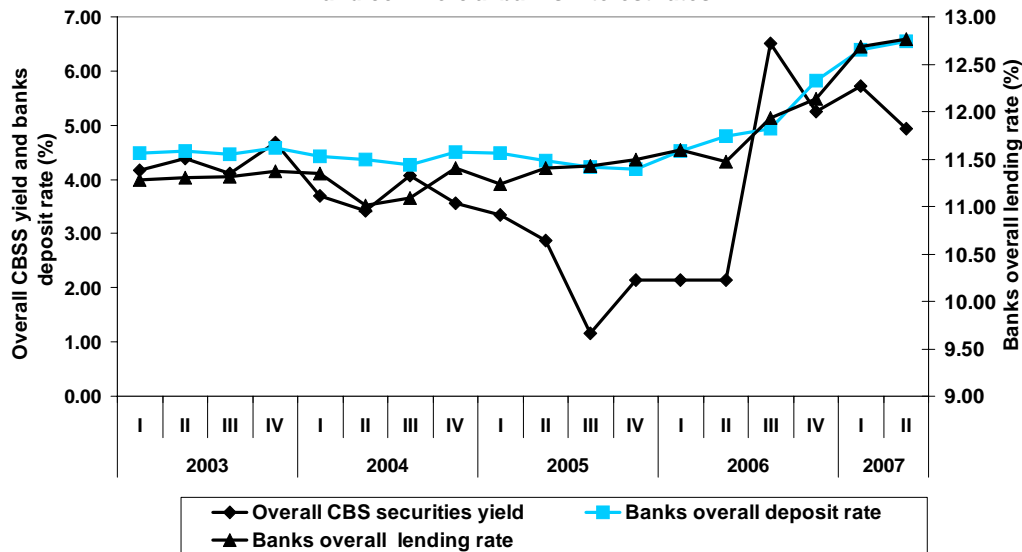


The Government’s financial operations in the June 2007 quarter registered a quarterly cash surplus of \$17.2 million vis-à-vis the monetary system due mainly to an increase in Government’s net

deposits with the commercial banks of \$20.6 million. This accumulation of funds by Government helped support the tight stance adopted by monetary policy in 2006/07.

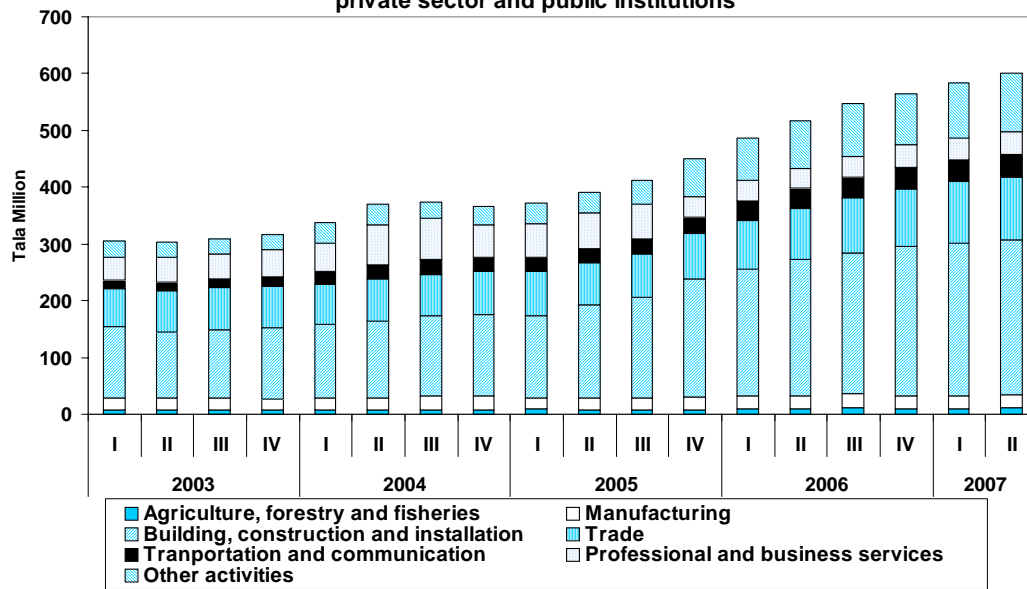
The continued improvement in the overall liquidity position of the commercial banks saw the weighted average official interest rate ease to 4.94 percent at end June 2007 from 5.73 percent at the end of the previous quarter. Reflecting the large inflow of foreign funds and reduction of the SRD ratio, the improved liquidity position of the banks saw an improvement in private sector deposits, assisted by an increase in the commercial banks' weighted average deposit rate (up 14 points to 6.54 percent). On the credit side, the average lending rate edged up 7 points to 12.76 percent following a 55 points rise in the previous quarter. In the event, the commercial bank's interest rate spread narrowed to 6.22 percent from 6.29 percent in the previous quarter. (See Graph 4.)

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



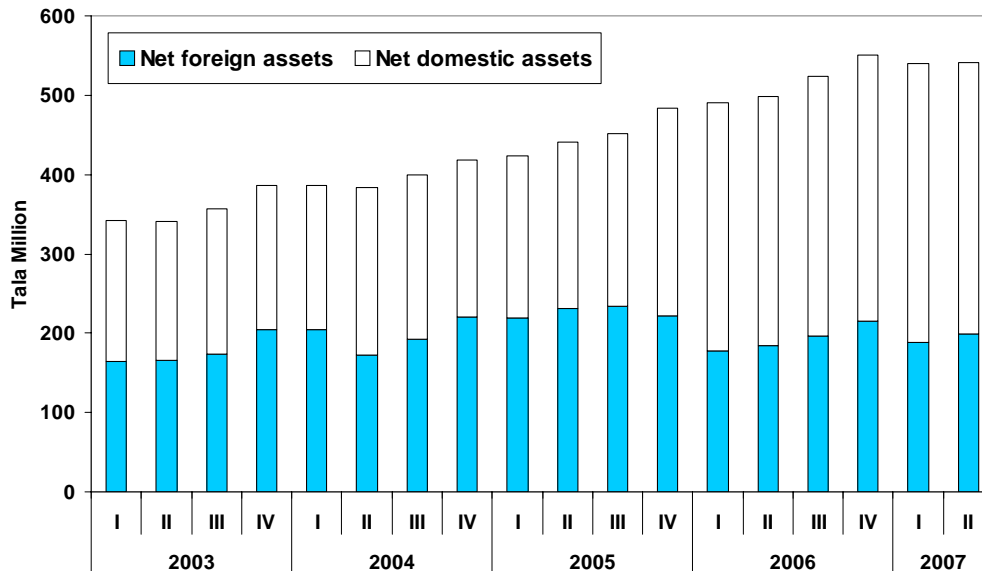
Strong demand for credit by the private sector and Government Corporations saw bank credit to the private sector and public institutions combined increase \$16.3 million to \$600.6 million in the quarter under review, slightly lower than a \$19.4 million hike in the previous quarter. Loans to the 'Building and construction' sector grew \$5.4 million to \$273.5 million on top of a \$4.4 million rise in the March 2007 quarter. Loans to the 'Other' and 'Trade' sectors went up \$5.2 million and \$2.8 million respectively to \$97.2 million and \$113 million in that order. (See Graph 5.)

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



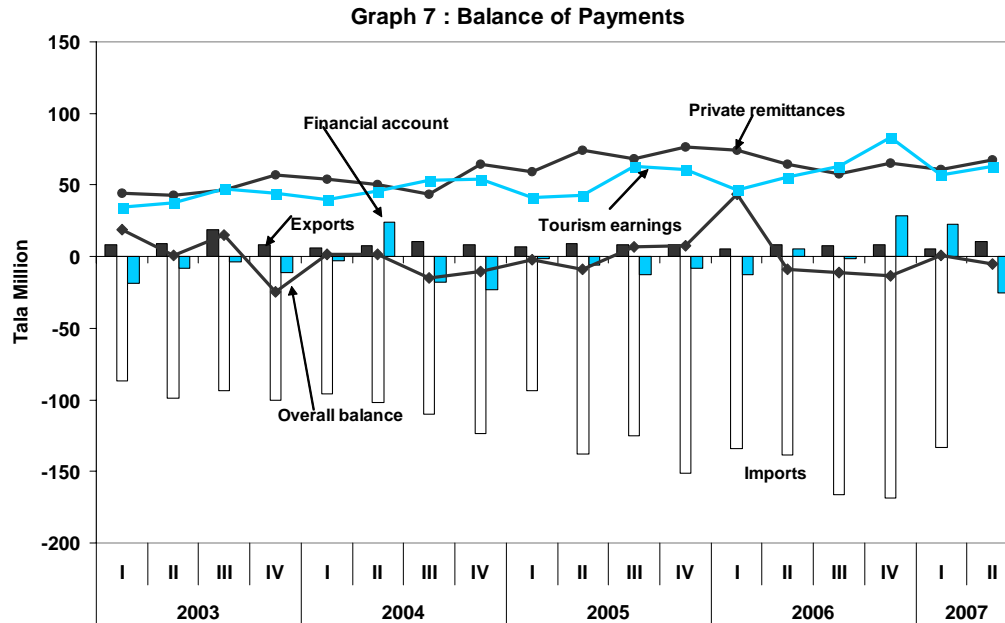
A 6 percent increase in net inflows of foreign funds, was partially offset by an 8 percent drop in net domestic assets, resulting in a slight rise of 0.4 percent in M2 in the quarter to end June 2007. (See Graph 6.)

Graph 6 : Money supply (M2)



On the balance of payments, a surplus of \$4.9 million was recorded in the June 2007 quarter, compliments of a surplus in the current account which reflected the continued success of tourism and increased inflows of private remittances and, to a lesser extent, a rebound in exports. (See Graph 7.) Foreign exchange earnings from tourism in the quarter under review expanded 11 percent or \$6.2 million on account of an 18 percent rise in tourist arrivals despite a 7 percent seasonal decrease in average tourist expenditure. As usual, the majority of tourists that visited Samoa in the second quarter of 2007 were those from New Zealand (41 percent), American Samoa (21 percent) and Australia (18 percent). Most of the tourists were here to visit friends and relatives (41 percent) and those who were here purely on holiday (33 percent). Private remittances rose 12

percent (\$7.2 million) following a 5 percent hike in household remittances and a 60 percent jump in remittances for charitable organizations.

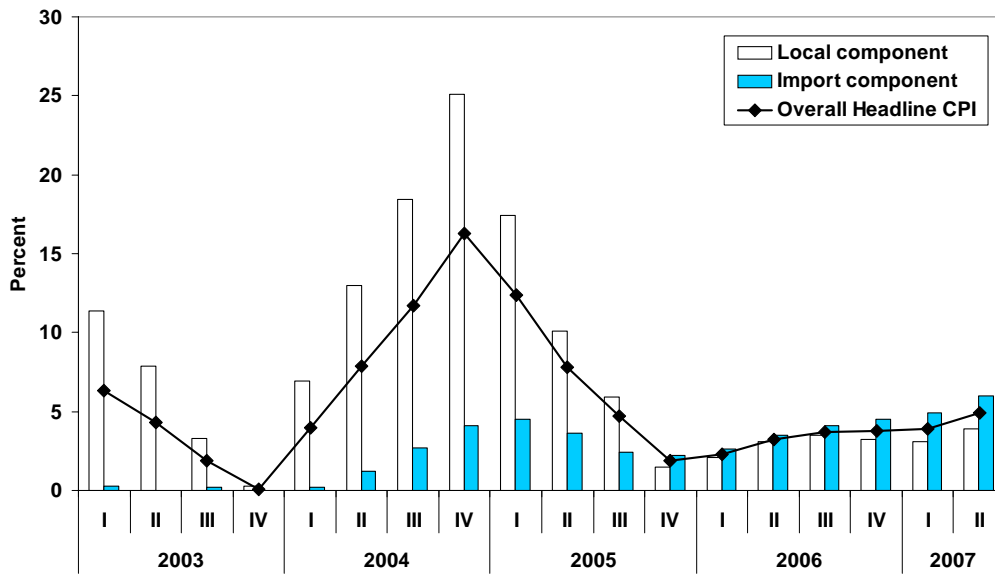


The merchandise trade deficit, on the other hand, widened 8 percent reflecting an 11 percent (\$14.9 million) growth in imports, partially offset by a doubling (\$5.2 million) in export earnings. Private sector imports rose 9 percent (up \$9.0 million) reflecting a strong increase in consumer goods, particularly imports of prepared foodstuffs and homeware appliances. In addition, petroleum imports jumped 17 percent or \$4.8 million and Government imports rose 13 percent (\$1.6 million). The rebound in total export earnings in the second quarter of 2007 to \$10.4 million was due mainly to a substantial recovery in domestic exports and a 43 percent increase in re-exports.

The surge in domestic exports reflected a \$4.2 million hike in fish export earnings with revenues from nonu juice and coconut cream up 56 percent and 98 percent respectively to \$1.2 million and \$756 thousand in that order. Soft drinks proceeds also more than doubled while that of pure coconut oil resumed with shipments valued at \$51 thousand.

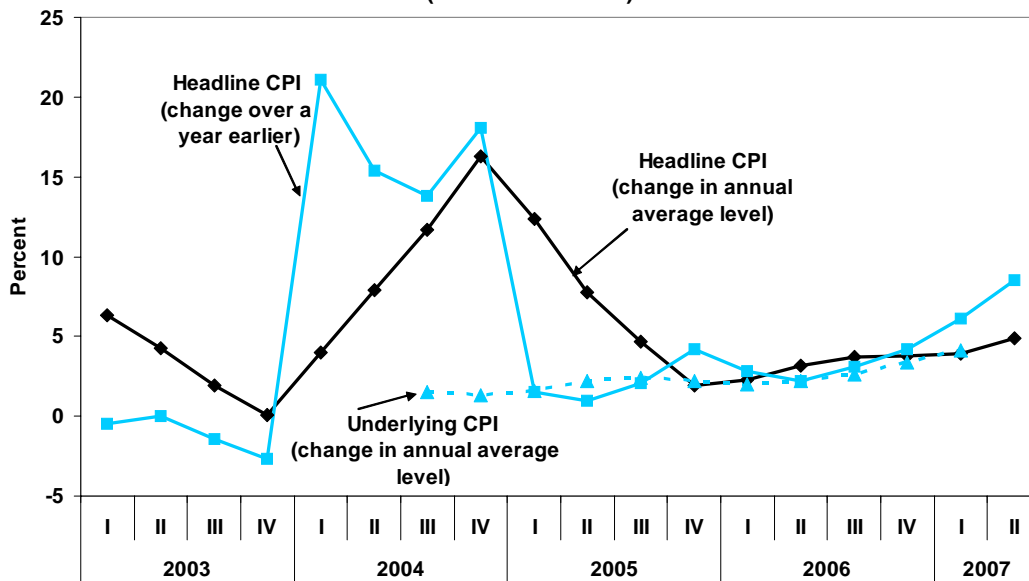
On prices, the average level of headline consumer prices rose 1.2 percent in the June quarter of 2007 to a level 6.9 percent higher than in the same quarter a year earlier. (See Graph 8a.) The increase in the headline Consumer Price Index reflected mainly an increase of 1.8 percent in the overall imported component as well as a 0.8 percent rise in the overall local component. The imported component of "Transport and Communication" recorded a substantial increase of 10.3 percent due to the continued rise in international oil prices. For the local component of the CPI, the increase in excise tax on tobacco saw the local component of "Alcohol and tobacco" sub-index rise by 3.5 percent.

Graph 8a : Headline Consumer Price Index



In the event, the headline rate of inflation, on an annual average basis, edged up to 4.9 percent at end June 2007 from 3.9 percent at end March 2007 and 3.2 percent at end June 2006. (See Graph 8b.) Similarly, the underlying rate of inflation rose to 5.6 percent from 4.1 percent at end March 2007 and 2.2 percent at end June 2006. The increased rates of headline and underlying inflation reflected the adverse impact of strong demand pressures and the increased VAGST and excise taxes.

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



III. PRUDENTIAL SUPERVISION

For the quarter ended 30 June 2007, the banking system continued to grow in terms of total assets against the upward trend in liabilities. An adequate level of capital has been maintained, comfortably above the Central Bank's minimum requirement of 15.0 percent, as liquidity levels improved.

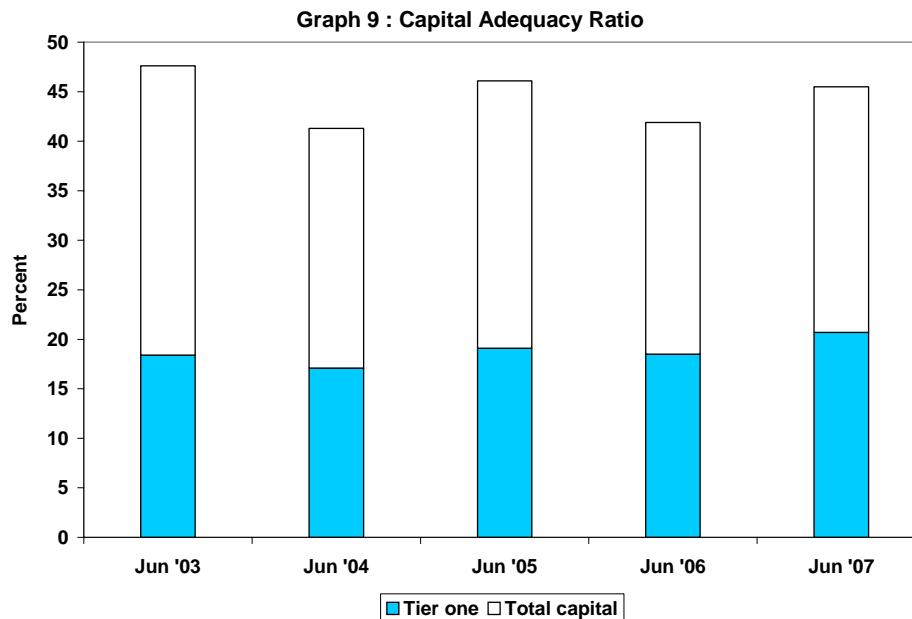
At \$773.3 million, the commercial banks combined assets reflected an increase of 1.8 percent (\$13.5 million) in the June quarter which indicated an annual growth of 12.0 percent (\$82.8 million) when compared to the same time a year earlier. The composition of the commercial banks assets comprised mainly of loans and advances of \$614.5 million (79.5 percent of total assets), cash reserves and deposits with the Central Bank and other banks combined at \$119.8 million (15.5 percent) and fixed assets of \$48.8 million (6.3 percent) respectively.

Total loans and advances of \$614.5 million increased 1.5 percent (\$9.4 million) at the end of the quarter and further increased by 13.8 percent (\$74.4 million) over the same time a year earlier. The strong growth in loans and advances was attributed mainly to loans to private businesses and households and Government.

Total deposit liabilities showed an increase of 2.6 percent (\$14.8 million) over the previous quarter, recording an annual growth rate of 10.4 percent (\$55.0 million) respectively. Time deposits (\$334.5 million) represented 57.1 percent of total deposits, demand deposits (\$180.1 million) accounted for 30.7 percent while savings deposits (\$71.2 million) made up 12.2 percent of total deposit liabilities.

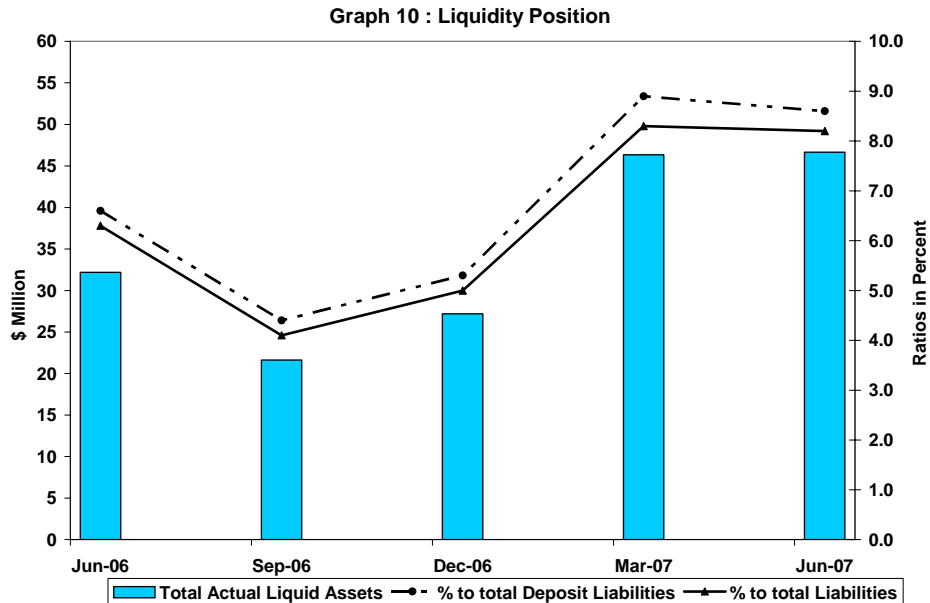
Total contingent and off-balance sheet items moved up 23.0 percent (\$19.8 million) to \$105.6 million over the previous quarter, due mainly to increases in unused credit commitments and unexpired foreign exchange contracts.

The banking system remained strongly capitalized at \$138.7 million, revealing an increase of 2.1 percent (\$2.9 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 down 0.1 percent to 24.8 percent. Tier 1 capital of 20.7 percent dropped 0.5 percent over the March 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.

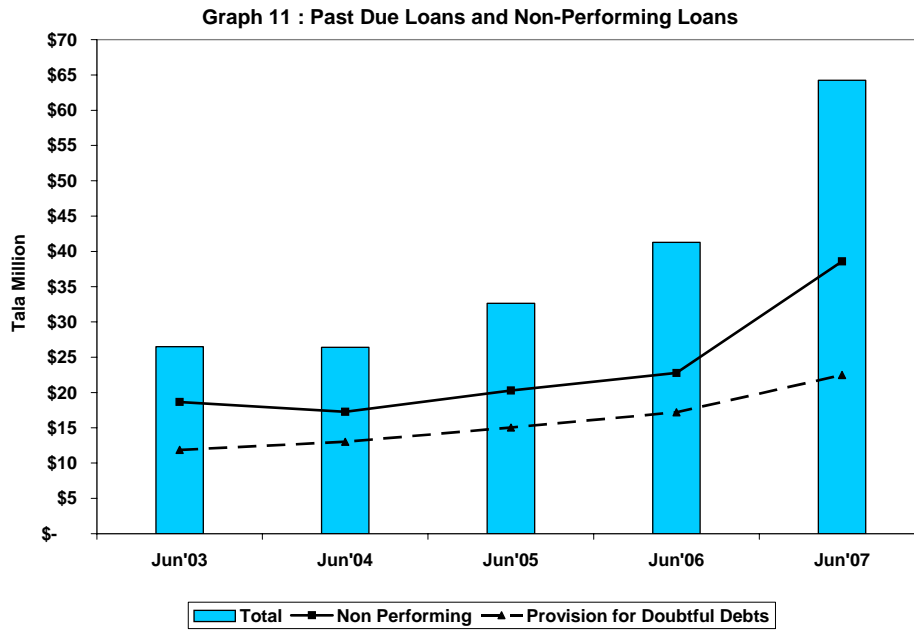
The banking system also revealed an improvement in the level of liquid assets by 0.7 percent (\$0.3 million) over the previous quarter and further increased 44.9 percent (\$14.5 million) when compared to the past twelve months level. Total liquid assets stood at \$46.7 million, equivalent to 8.6 percent of total domestic deposit liabilities Central Bank Securities of \$11.4 million made up 24.5 percent of total liquid assets at the end of the quarter. (See Graph 10.)



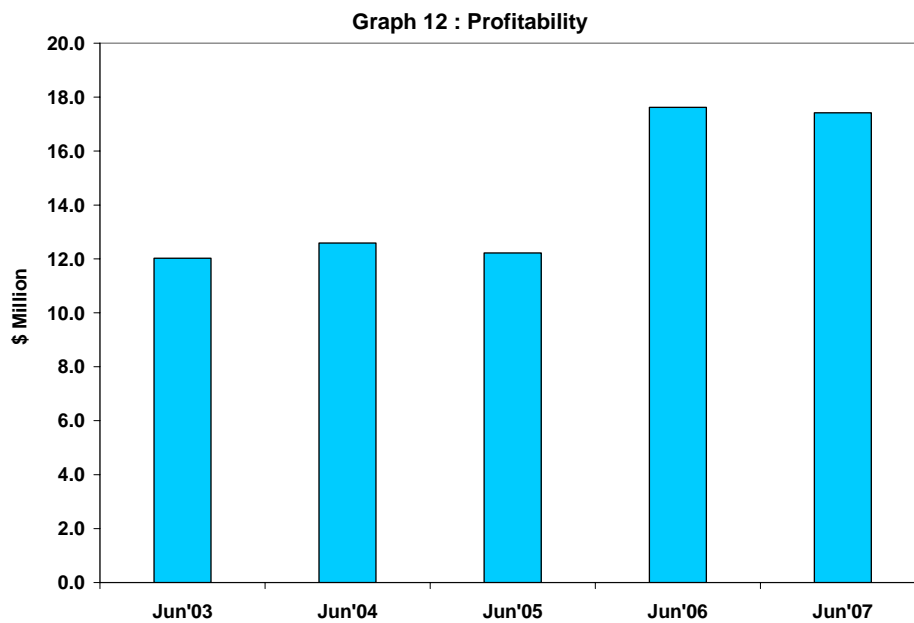
The combined foreign assets of the commercial banks amounted to \$77.1 million as compared to total foreign liabilities of \$76.5 million. At these levels, it showed a net long exposure position of around \$2.9 million or 2.1 percent of total capital.

Total non-performing loans, however, deteriorated further with a 12.5 percent increase in problem loans, now reaching \$38.6 million. As compared to the prior year, non performing loans rose markedly by 69.5 percent (\$15.8 million). At \$22.5 million, total provision for bad and doubtful debts provided a 58.3 percent buffer against possible loan losses that may derive from non-performing loans. As a proportion of total loans and advances, total provisions stood at 3.7 percent.

The Central Bank has continued to monitor closely the banks performances towards reducing their levels of arrearages and non-performing loans, which warrants the need for banks to be extra vigilant in their approaches towards asset quality. Equally important, banks must ensure to have adequate provisions to cover for such problem loans while recovery efforts are being pursued. (See Graph 11.)



At a combined figure of \$24.4 million, the banking system’s pre tax profit level decreased 1.2 percent in the quarter under review when compared to the same period a year earlier. Total net profit after tax amounted to \$17.4 million, down slightly from \$17.6 million recorded a year earlier. At this level, return on average networth and assets stood at 13.2 percent and 2.2 percent respectively. (See Graph 12.)



For the period under review, total operating expenses represented 66.7 percent of total income as compared to 60.3 percent achieved in the previous year indicating a strong rise in banks expenditures against earnings.
