

II. OVERVIEW OF ECONOMIC DEVELOPMENTS DURING THE FIRST QUARTER OF 2008

a. The World Economy

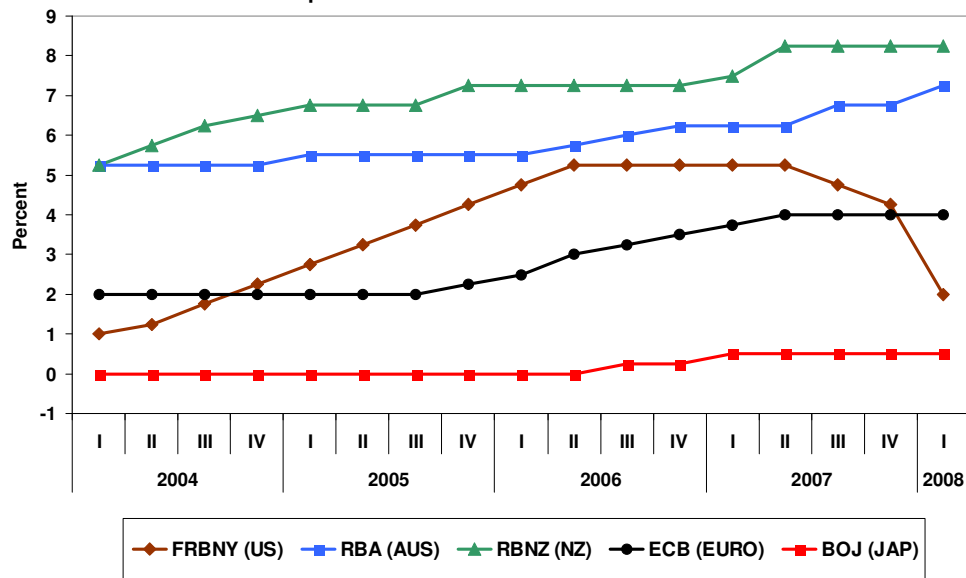
The slowing down in the global economy in the March quarter of 2008 has been more pronounced in the United States while other advanced economies have also showed signs of softening this year. Recent data have shown little growth in the US economy in the March quarter, with slowing consumer spending and housing construction activity still causing setbacks to growth. In the euro area, business conditions and consumer sentiment have declined, with moderate growth in demand. Japan similarly is experiencing weaker conditions this year. In Australia there has been a noticeable decline in the pace of demand growth and output over the past few months. In New Zealand, economic growth also appeared to have softened in the March quarter.

The March quarter national accounts indicated that economic activity was subdued in the United States in the first quarter of 2008. Although sluggish, the data showed that the US Real GDP grew at an annual rate of 0.9 percent in the March quarter, up from 0.6 percent in the previous quarter. Household consumption increased 0.2 percent in the March quarter, its slowest pace in 13 years, accompanied by weaker consumer sentiment. Residential and business investment also fell in the quarter under review. The labour market weakened significantly with the unemployment rate rising 0.1 percent to 4.9 percent. The Housing market remained weak with permits down to 60 percent from their peaks in 2005. In contrast, solid growth in exports continued, supported by the depreciation of the US dollar. While the CPI has risen to 4.0 percent over the year to the March quarter, the core measure was at 2.4 percent and expected to moderate in coming quarters.

In its March quarter meetings, the Federal Open Market Committee (FOMC) cut interest rates by a total of 200 basis points, taking the Fed funds rate from 4.25 percent to 2.0 percent. Recent data indicated that economic activity remained weak. Household and business spending has been subdued and labour markets have softened further.

Inflation in Australia picked up momentum in 2007 and this upward trend continued into 2008. Reining in the inflation rate to target levels will necessitate a significant slowing in demand over time. Whereas recent data showed that the Australian economy grew at a robust annual pace of 3.6 percent in the first quarter, which kept alive expectations for higher future interest rates, previously released data in the March quarter of 2008 suggested a slowing in the pace of demand growth and output over the past few months in response to high interest rates. Consumer and business sentiments fell sharply. Retail sales declined slightly and the established housing market cooled down. In contrast, the labour market still remained tight as employment continued to expand in the March quarter with unemployment remaining close to its recent low of 4.1 percent. The tight labour market continued to support real disposable income in the quarter given the strong employment growth. Export volumes are estimated to increase solidly in the quarter, to be around 3.0 percent higher over the year. Stronger inflation figure was recorded in the second half of 2007, and the year-ended inflation rate rose further in the March quarter. The CPI increased by 1.3 percent in the quarter under review and by 4.2 percent over the year.

Graph 1 : Official International Interest Rates



In the March quarter, the Reserve Bank of Australia increased the cash rate twice by a total of 50 basis points to 7.25 percent. The move by the RBA was to contain and reduce inflation over the medium term due to strong domestic demand and tight labour market conditions.

The New Zealand economy appeared to have softened in the March quarter. Activity and business confidence indicators fell sharply across the majority of sectors. The slowdown in domestic demand was also evident in recent developments in the household sector. House sales in the March month fell further, while the number of building consents also declined, implying residential investment will soften in subsequent quarters. Retail sales eased in February and recent electronic card transactions suggested consumer spending will continue to moderate in March. High interest rates and rising costs have been weighing heavily on households and, as a result, private consumption growth softened. A decline in exports in March also pointed to weak growth in the quarter. However, annual inflation rose from 3.2 percent in December to 3.4 percent in March. Key contributors were price increases for food, transport and housing.

In the March quarter, the Reserve Bank of New Zealand kept its official cash rate unchanged at 8.25 per cent. The main reasons are weaker prospects for world growth, tighter credit conditions, a sharper-than-expected slowing in the housing market, and recent dry weather conditions.

The recent data and survey information on economic activity in the euro area confirmed moderate but ongoing growth in the first quarter of 2008. In particular, industrial production data for the first three months of the year showed resilience, while economic sentiment generally continued to soften. Household and business sentiment declined further in the March quarter 2008, although business sentiments remained more positive than household sentiment.

The European Central Bank in its December quarter interest rate reviews left its interest rate unchanged at 4.0 percent. The ECB cited that the latest data confirmed the assessment that upside risks to price stability prevailed over the medium term, in money and credit growth.

In the United Kingdom, the quarterly rate of real GDP growth in the March quarter showed a moderation of 0.4 percent from 0.6 percent in the previous quarter. At the same time, quarterly growth in retail sales in the quarter was above market expectations, while consumer confidence

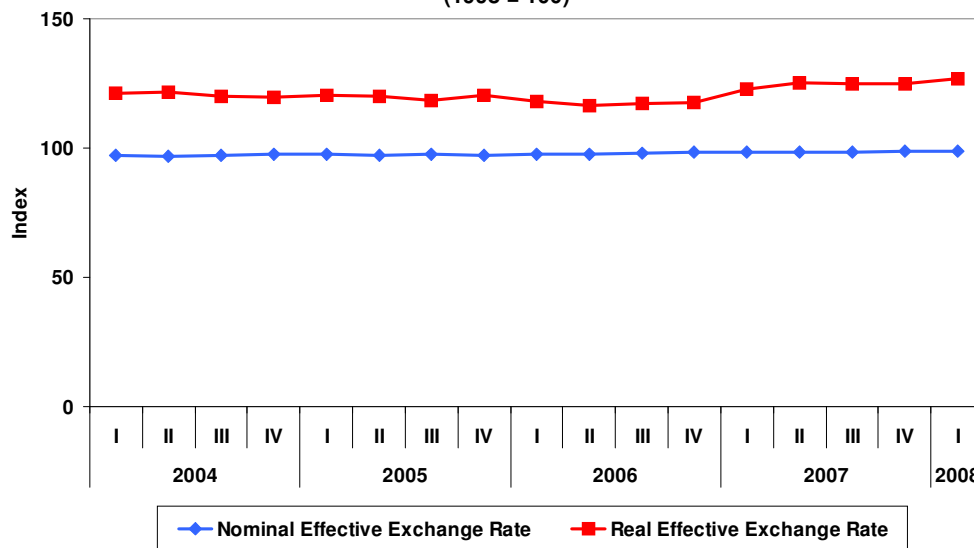
indicators have declined. In March 2008 annual inflation remained unchanged at 2.5 percent. Producer prices rose further in March, owing mainly to higher petroleum product prices.

In the March quarter, the Bank of England cut its official cash rate by 0.25 percent to 5.25 percent from 5.50 percent. The Committee needed to balance the risk that a sharp slowing in activity pulls inflation below the target in the medium term.

In Japan, the results of the March 2008 Bank of Japan Tankan survey pointed to some further deterioration in business conditions for large companies in the first quarter of 2008, against the background of rising uncertainty in the global economy. Moreover, business sentiment among small and medium-sized enterprises worsened further. Overall, the latest Tankan release pointed to a less favourable short term outlook for the Japanese economy. Consumer price inflation picked up as a result of the rise in the price of imported raw materials, while domestic inflationary pressures remained subdued. In March 2008 the annual change in the CPI was 1.2 percent, after 1.0 percent in February, mostly driven by the prices of energy and processed food products. In their March quarter meetings, the Bank of Japan decided to leave its target for the uncollateralized overnight call rate unchanged at 0.50 percent.

The major development in foreign exchange markets in the quarter under review was the continued depreciation of the US dollar against most other major currencies. Against the currencies of our major trading partners, the Tala depreciated against the Australian dollar, New Zealand dollar, Euro dollar and the Fiji dollar but rose against the US dollar. The value of the Tala in terms of its nominal index showed an appreciation of 0.39 per cent in the first quarter of 2008. Furthermore, since Samoa's rise in prices is higher than that of our major trading partners, the real effective exchange rate of the Tala rose 2.11 percent.

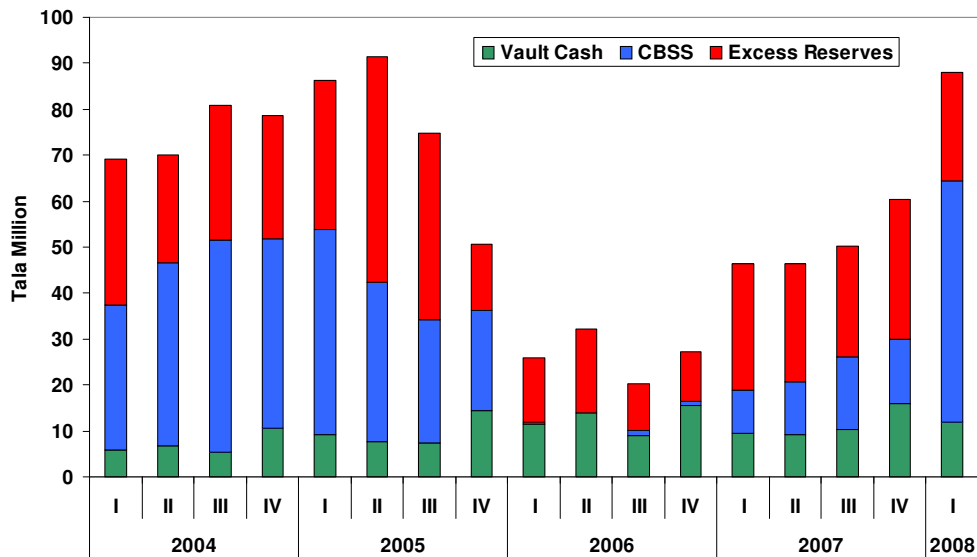
**Graph 2 : Trade Weighted Exchange Rate Index
(1998 = 100)**



b. The Domestic Economy

The continued easing of monetary conditions led to a significant expansion in total commercial bank liquidity (comprised of holdings of CBS securities, excess reserves and cash holdings) in the March quarter of 2008. After a \$10.1 million increase in the previous quarter, total liquidity of the banking system rose \$27.6 million to \$88.0 million which saw commercial banks investments in CBS securities surge to \$52.5 million at the end of the quarter from \$13.9 million in the preceding quarter. (See Graph 3.)

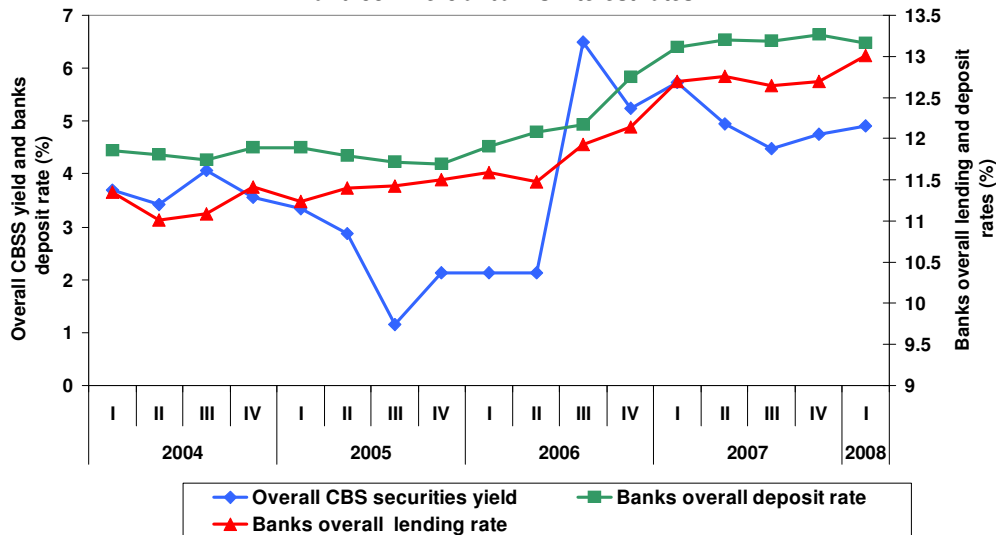
Graph 3 : Commercial Banks Total Liquidity



The Government’s financial operations in the March quarter of 2008 registered a quarterly cash surplus of \$19.7 million vis-à-vis the monetary system, thus assisting the tightened stance adopted by monetary policy in 2007/08. The surplus was mainly due to an increase of \$16.3 million in Government’s net deposits with the commercial banks.

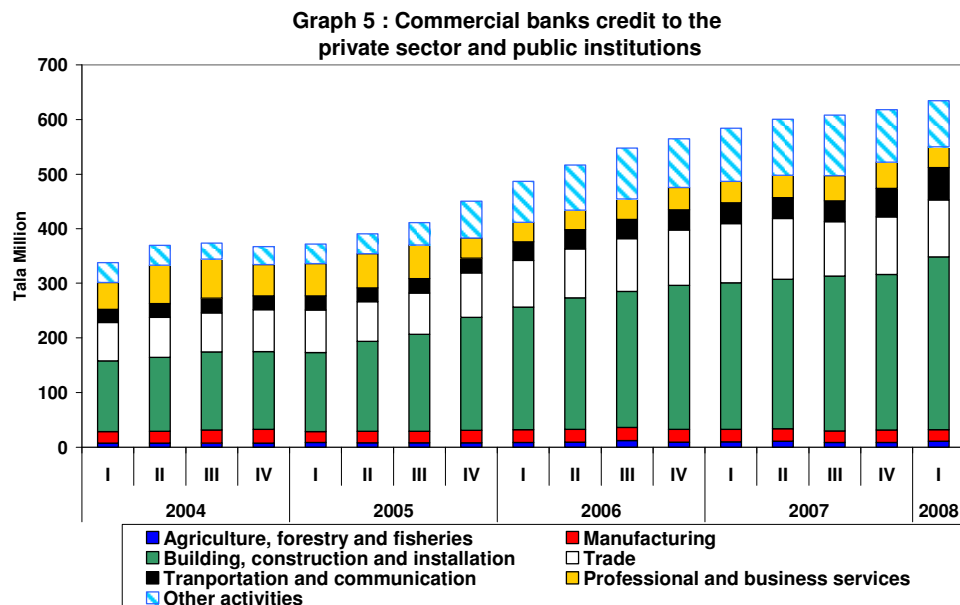
The significant increase in investment in short term securities saw the weighted average official interest rate rise to 4.91 percent at end March 2008 from 4.75 percent at end December 2007. On commercial banks interest rates, the weighted average lending rate increased by 31 points to 13.01 percent while the weighted average deposit rate fell 15 points to 6.47 percent. In the event, the commercial bank’s interest rate spread widened to 6.54 percent from 6.08 percent in the previous quarter. (See Graph 4.)

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

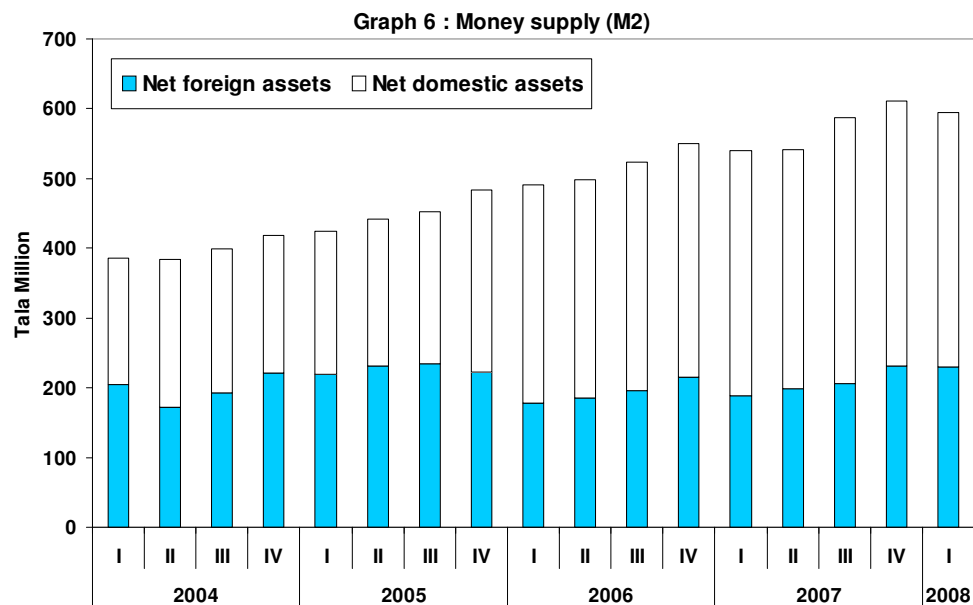


Strong demand for credit by the private sector and Government corporations saw bank credit to the private sector and public institutions combined increase by \$16.8 million to \$638.1 million in the quarter under review, higher than a \$10.1 million hike in the previous quarter. Loans to the

'Building and construction' sector leapt \$32.8 million to \$316.4 million in the March 2008 quarter. Loans to the 'Electricity' and 'Trade' sectors went up \$2.6 million and \$2.3 million respectively to \$6.4 million and \$36.4 million in that order. (See Graph 5.)

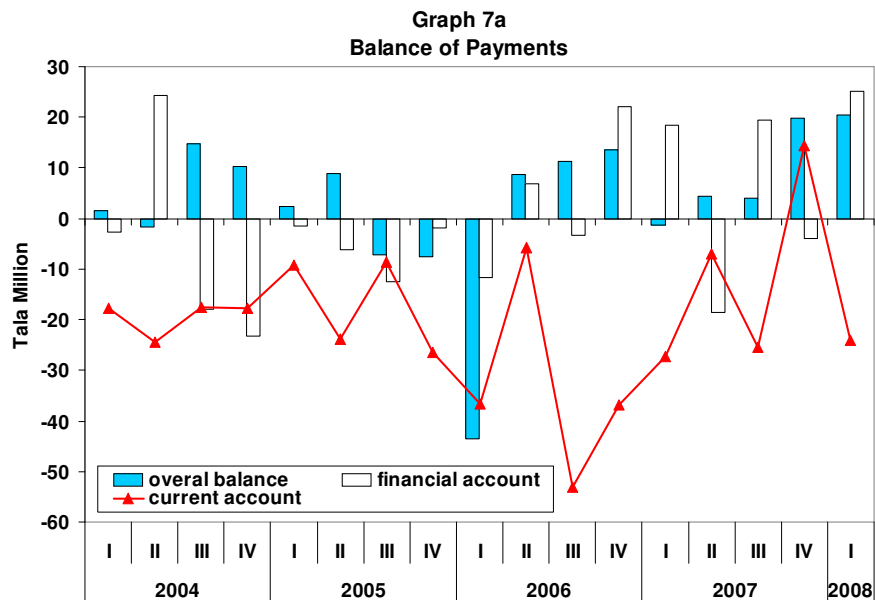


With a 4 percent reduction in domestic assets from an improved Government position and a 1 percent decline in net foreign assets, total money supply (M2) fell 2.7 percent (\$16.6 million) to \$594.5 million in the March 2008 quarter. (See Graph 6.)



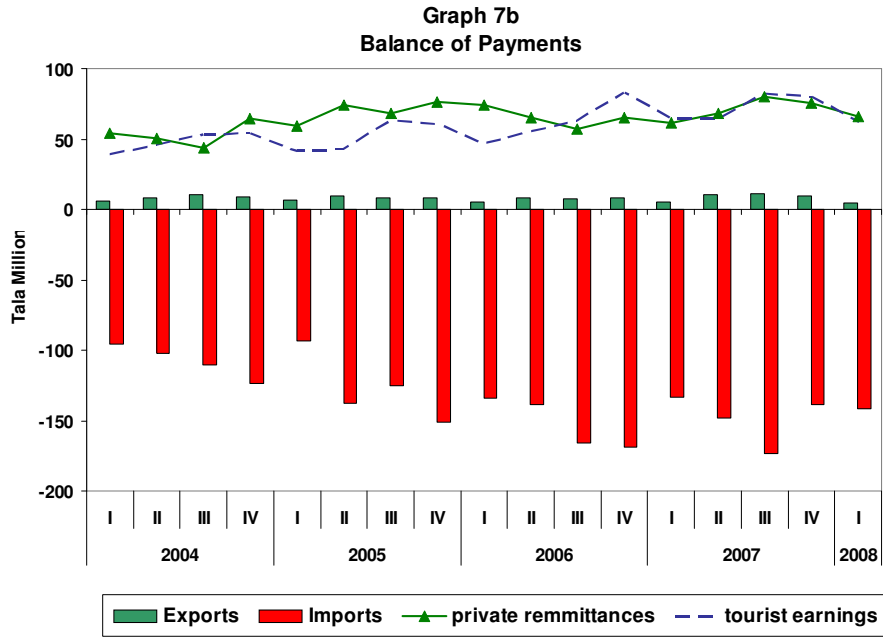
On the balance of payments, an overall surplus of \$20.5 million was recorded in the March 2008 quarter on the back of another large surplus of \$19.88 million in the previous quarter, compliments of a large inflow of funds in the Financial Account. In line with seasonal patterns, foreign exchange earnings from tourism in the quarter under review dropped 23 percent or \$18.1 million on account of a 30 percent drop in tourist arrivals and a 7 percent seasonal decrease in average tourist expenditure. As usual, the majority of tourists that visited Samoa in the first quarter of 2008 were from New Zealand (38 percent), American Samoa (19 percent) and Australia (18 percent). Most of the tourists were here to visit friends and relatives (45 percent) and those

who were here purely on holiday (39 percent). (See Graph 7a.) Private remittances declined 12 percent (\$9.1 million) due to a 9 percent drop in household remittances and a 25 percent reduction in remittances for charitable organizations.

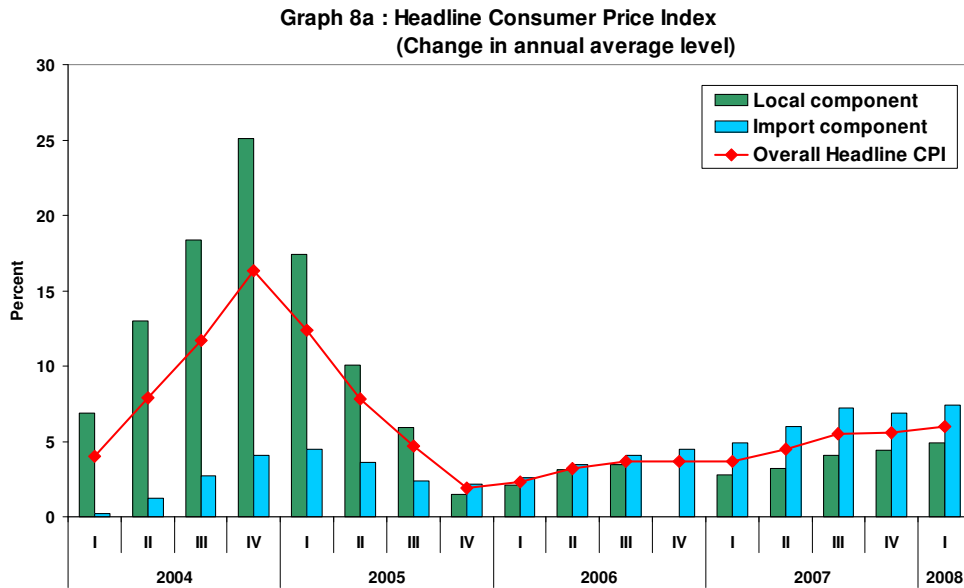


The merchandise trade deficit, on the other hand, widened 7 percent reflecting a 2 percent (\$3.4 million) growth in imports and a 55 percent (\$5.2 million) decrease in export earnings. Petroleum imports jumped 56 percent or \$15.3 million due mainly to international price hikes for oil and Government imports rose \$2.2 million in the quarter under review. Private sector imports, on the other hand, tumbled 13 percent (\$14.1 million) reflecting the reduction in motor vehicle imports.

The drop in total export earnings in the first quarter of 2008 to \$4.2 million was mainly due to the usual seasonal downturn following the end of year high demand. Earnings from fresh fish, nonu juice, coconut cream, beer and nonu fruit declined 79 percent, 51 percent, 32 percent, 21 percent and 73 percent respectively to \$1.0 million, \$499 thousand, \$469 thousand, \$683 thousand and \$40 thousand in that order. On the positive side, earnings from pure coconut oil, taro, coconuts and soft drinks rose eight-fold, 16 percent, 47 percent and 3 percent to \$46 thousand, \$160 thousand, \$143 thousand and 64 thousand in that order. (See Graph 7b.)

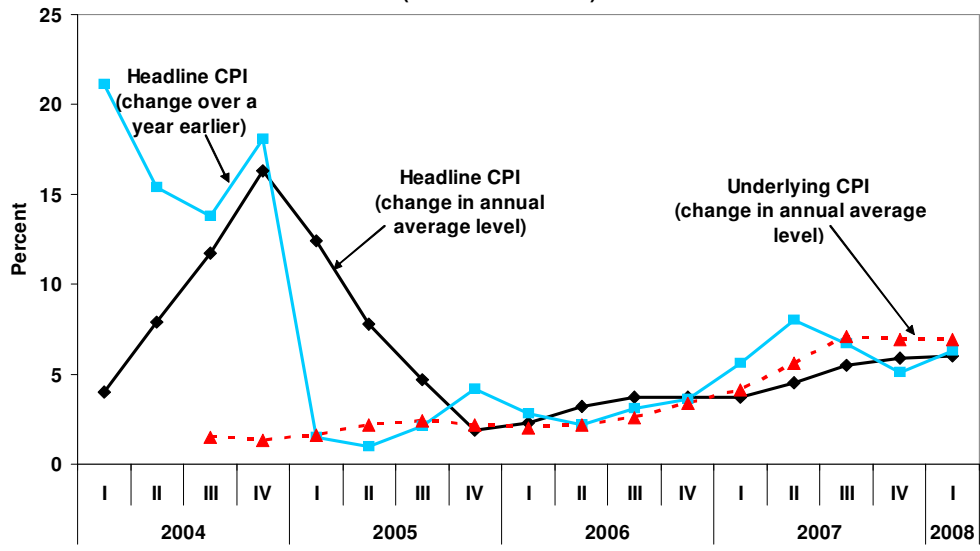


On prices, the average level of headline consumer prices rose 4.2 percent in the March quarter of 2008 to a level 6.3 percent higher than in the same quarter a year earlier. (See Graph 8a.) The increase in the headline Consumer Price Index mainly reflected an increase of 5.0 percent in the overall local component as well as a 3.1 percent rise in the overall import component. The import component of “Transport and Communication” recorded a substantial increase of 12.3 percent due to the continued rise in international oil prices. For the local component of the CPI, the increase in food crops at the local Market saw the local component of the “Food” sub-index rise by 11.4 percent.



In the event, the headline rate of inflation, on an annual average basis, edged up to 6.0 percent at end March 2008 from 5.6 percent at end December 2007 and 3.7 percent at end March 2007. Similarly, the underlying rate of inflation, at 6.9 percent, was unchanged compared to end December 2007 but was substantially higher than the 4.1 percent at end March 2007. The increased rates of headline and underlying inflation reflected the adverse impact of strong demand pressures and increased food and oil prices. (See Graph 8b.)

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



III. PRUDENTIAL SUPERVISION

For the quarter ended 31 March 2008, 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.

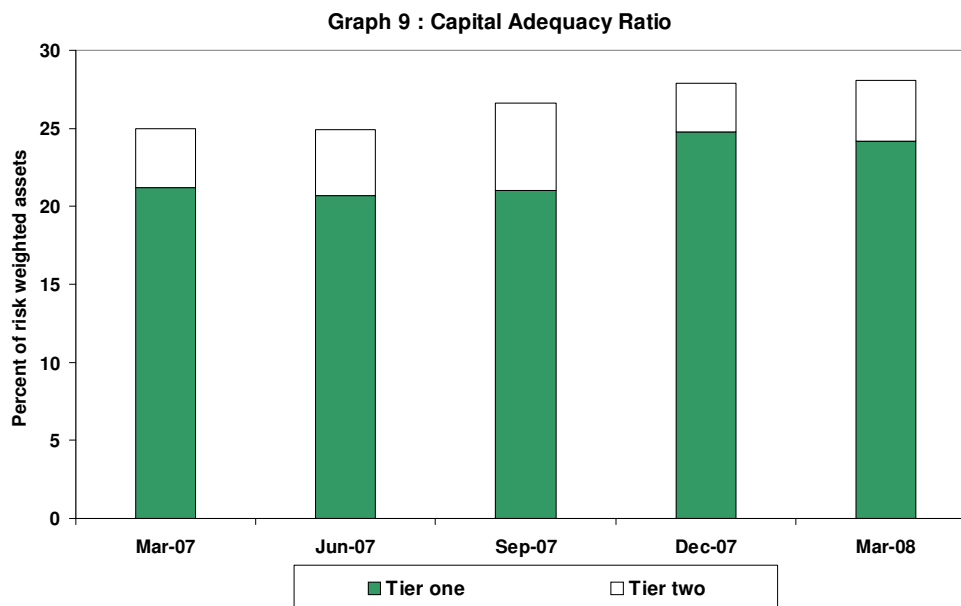
At \$852.6 million, the commercial banks combined assets reflected an increase of 2.8 percent (\$23.3 million) in the March quarter and indicated an annual growth of 12.2 percent (\$92.7 million) when compared to the same time a year earlier. The composition of the commercial banks assets comprised mainly of loans and advances of \$653.2 million (76.6 percent of total assets), cash reserves and deposits with the Central Bank and other banks combined at \$153.4 million (18.0 percent) and fixed assets of \$49.8 million (5.8 percent) respectively.

Total loans and advances of \$653.2 million increased by 2.1 percent (\$13.3 million) at the end of the quarter and by 8.0 percent (\$48.1 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 2.8 percent (\$17.3 million) over the previous quarter, thus recording an annual growth rate of 12.8 percent (\$72.9 million) respectively. Time deposits (\$394.6 million) represented 61.3 percent of total deposits, demand deposits (\$178.0 million) accounted for 27.6 percent while savings deposits (\$71.2 million) made up 11.1 percent.

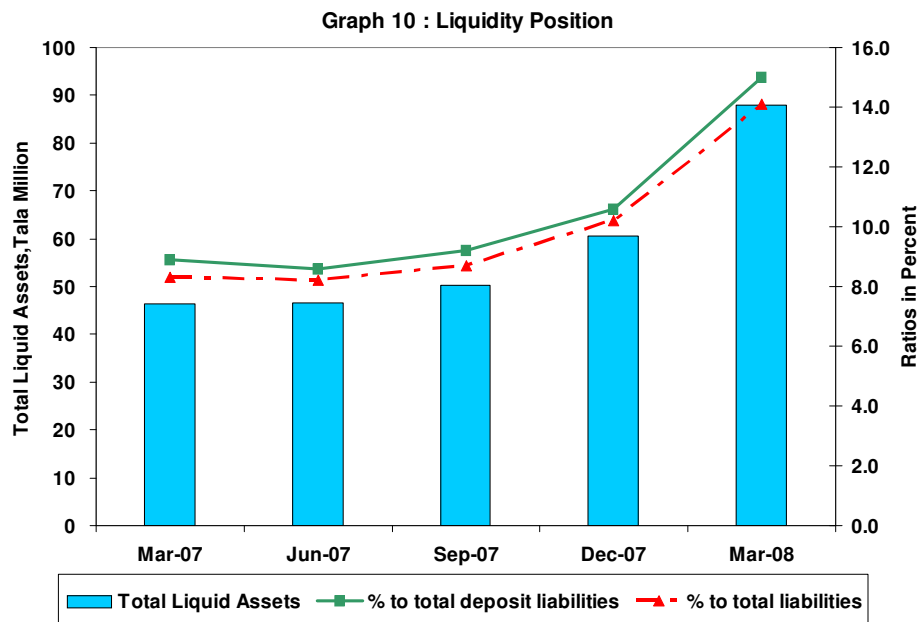
Total contingent and off-balance sheet items went down by 19.4 percent (\$21.0 million) to \$87.5 million over the previous quarter, due mainly to decreases in both unmatured foreign exchange contracts and unused credit commitments.

The banking system's capital stood at \$152.6 million, revealing a decrease of 0.4 percent (\$0.6 million) over the previous quarter. In relation to the overall level of risk weighted assets, the capital adequacy ratio edge upward from 28.0 percent to 28.1 percent. Tier 1 capital of 24.2 percent decreased by 0.6 percent over the December 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 recorded an improvement in the level of liquid assets by 45.6 percent (\$27.6 million) over the previous quarter and by 90.0 percent (\$41.7 million) when compared to the past twelve months level. Total liquid assets stood at \$88.0 million, equivalent to 15.0 percent of total domestic deposit liabilities. Holdings of Central Bank Securities of \$52.5 million made up 59.6 percent of the banking system's total liquid assets at the end of the quarter under review. (See Graph 10.)

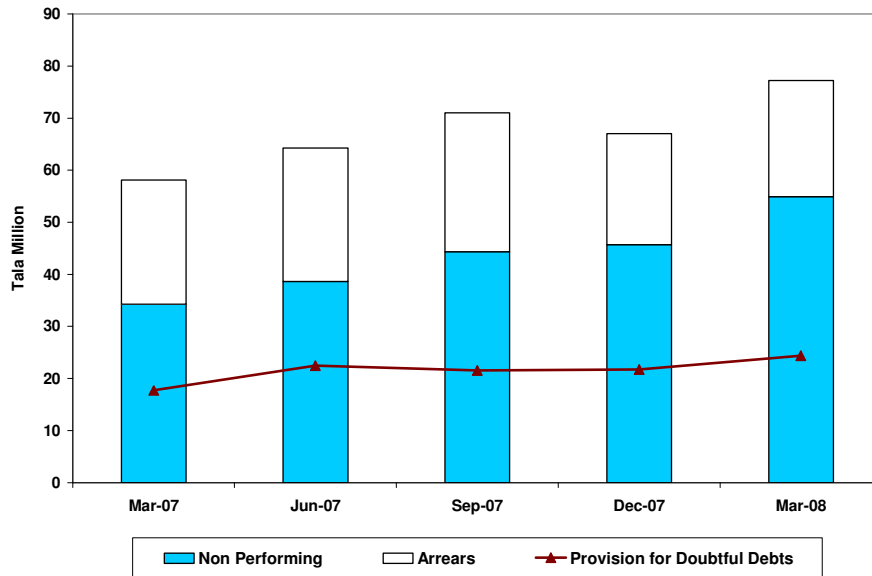


At end March 2008, the combined foreign assets of the commercial banks amounted to \$92.2 million as compared to total foreign liabilities of \$88.7 million. At these levels, it showed a net long exposure position of around \$7.1 million or 4.6 percent of total capital.

For the quarter under review, total non-performing loans increased by 20.1 percent (\$9.2 million) to \$54.9 million. As compared to the prior year, non-performing loans increase by \$20.6 million respectively. In relation thereto, total provision for bad and doubtful debts of \$24.4 million provided a 44.4 percent buffer against possible loan losses that may derive from non-performing loans. As a proportion of total loans and advances, the total provision stood at 3.7 percent.

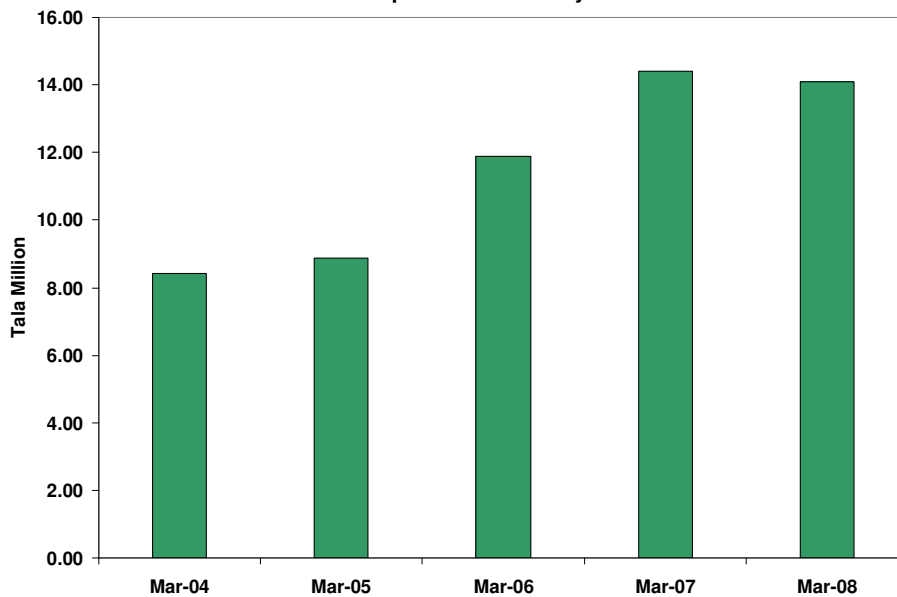
The Central Bank continued to monitor closely the banks' performances towards reducing their levels of arrearages and non-performing loans, which require them to be extra vigilant in their approaches towards asset quality. Equally important, is the need for the banks to ensure that adequate provisions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

Graph 11 : Past Due and Non-Performing Loans



At a combined figure of \$19.3 million, the banking system’s pre tax profit level decreased by 5.4 percent in the quarter under review when compared to the same period a year earlier. Total net profit after tax amounted to \$14.1 million, down from \$14.4 million recorded a year earlier. At this level, the return on average network and assets stood at 10.1 percent and 1.8 percent respectively. (See Graph 12.)

Graph 12 : Profitability



For the quarter under review, total operating expenses represented 70.6 percent of total income, more or less the level achieved in the same quarter of 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.
