

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

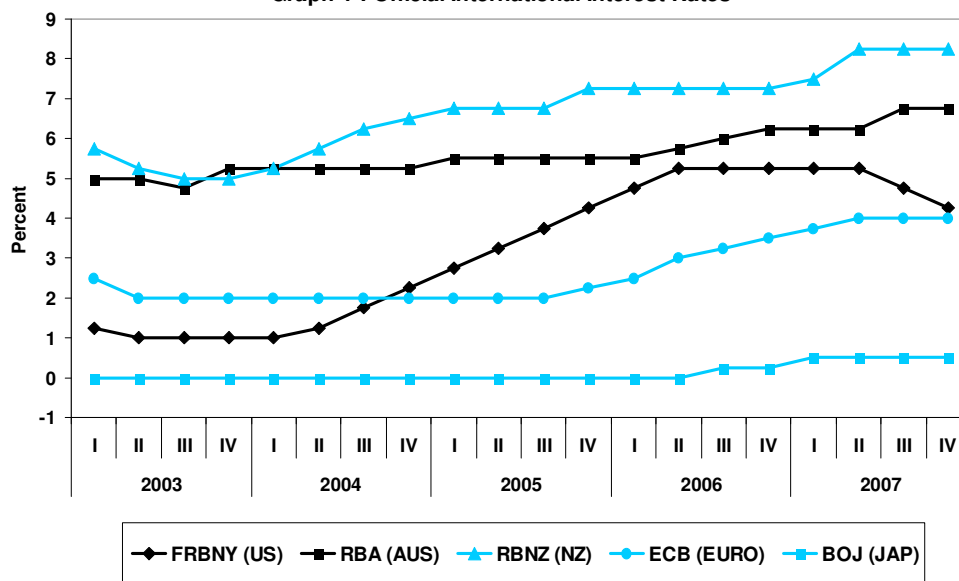
a. The World Economy

The world economy in the December quarter of 2007 showed signs of slowing due to ongoing turbulence within the credit markets that began in mid 2007. Strains in money markets around the world reached a peak in September and again in mid December. However, since that time, these strains have eased. But, money markets funding costs remain higher than they were before the turmoil began. As a result, central banks have acted to supply liquidity as needed. The deterioration in financial market sentiment has been associated with the weakening in the outlook for global economic growth. The US economy posted only modest growth in the December quarter and growth in the Euro Area and Japan have also slowed down. Australia and New Zealand also showed modest increases albeit at a lesser pace.

Most of the data for the US, released in January 2008, showed that the US economy weakened in the final quarter of 2007 due to the collapse of the housing market. However, prices continued to surge, increasing the threat of stagflation. The unemployment rate increased from 4.7 percent in November to 5.0 percent in December, a two-year high, and non-Government employment fell in December. The housing market showed continued weakness, with average prices down 10 percent annually on one measure. The advance release of GDP for the fourth quarter of 2007 showed that the economy grew at an annual rate of only 0.6 percent. The combination of increased pricing pressures and near dormant growth poses a policy dilemma for the Federal Reserve which cannot use monetary policy to tackle both simultaneously. The sharp pick-up in headline inflation in the December quarter was due to higher oil and food prices and core CPI inflation had risen more modestly to 2.4 percent over the year to December.

In its December quarter meetings, the Federal Open Market Committee (FOMC) cut interest rates by a total of 50 basis points, taking the Fed funds rate to 4.25 percent. The action by the Federal Reserve was in light of incoming data at the time that suggested that economic growth in the US was slowing, reflecting the correction in the housing market and softening in business and consumer spending.

Graph 1 : Official International Interest Rates



The Australian economy slowed in the fourth quarter of 2007, as a surge in imports growth eased the pressure on the Reserve Bank of Australia (RBA) to raise interest rates further. Recent data showed that Australia's real GDP grew at a seasonally adjusted annual pace of 3.9 percent in the December quarter, compared with 4.3 percent reported for the previous quarter. While the rise in imports took the pressure off demand, recent indicators suggested consumption growth remained solid, with real retail sales up by 1.6 percent to be 5.7 percent higher over the year. Export volumes increased slightly in the quarter, but was 4.25 percent higher over the year. In the event, the unemployment rate increased 0.1 percent to 4.3 percent in the fourth quarter of 2007. The December quarter consumer price index also noted a pick up in the inflation rate. The CPI rose 0.9 percent in the quarter and by 3.0 percent over the year.

In the December quarter, the Reserve Bank of Australia increased its cash rate by 25 basis points to 6.75 percent in its first meeting in order to contain inflation in the medium term. However, interest rates were kept on hold during its second meeting as heightened uncertainty about the international outlook and local trends in wholesale borrowing costs, could have a bearing on inflation over the medium term.

The New Zealand economy is estimated to record a modest increase in the fourth quarter of 2007. This outcome was based on the results for the September quarter which showed a modest increase as the economy continued to slow down. However, notably in the December quarter of 2007, there was an increase in inflation. The consumer price index rose 1.2 percent in the quarter, taking the annual rate to 3.2 percent from 1.8 percent at end September. The major contributors were higher fuel and food prices. Retail spending over the quarter reflected higher prices, while volume growth came in modest. The New Zealand manufacturing index for the December quarter represented slower growth and further weakness in the goods producing sector, following the negative contribution to growth in the previous quarter.

In the fourth quarter of 2007, the Reserve Bank of New Zealand kept its official cash rate unchanged at 8.25 percent. The board cited that the tight labour market, high capacity use, and rising oil and food prices all pointed to sustained inflationary pressures.

Recent data on economic activity in the December quarter pointed to a more moderate pace of growth in the Euro area compared to the previous quarter. This assessment was in line with indicators for business and consumer confidence which have declined but remain consistent with ongoing growth. Retail sales fell 0.7 percent over the year to the December quarter and export growth has slowed. Business and consumer sentiments also dropped.

The European Central Bank (ECB) in its December quarter interest rate reviews left its interest rate unchanged at 4.0 percent. The ECB cited the existence of strong short-term upward pressure on inflation within the Euro area.

In the United Kingdom, the quarterly rate of real GDP growth was 0.6 percent in the fourth quarter of 2007, down 10 percentage points from the previous quarter. Retail sales data showed that household consumption moderated in the last quarter of 2007. Activity and price indicators were generally down. In December, inflation was unchanged from the two previous months at 2.1 percent. The lower contribution of utility bills continued to offset higher fuel and food prices.

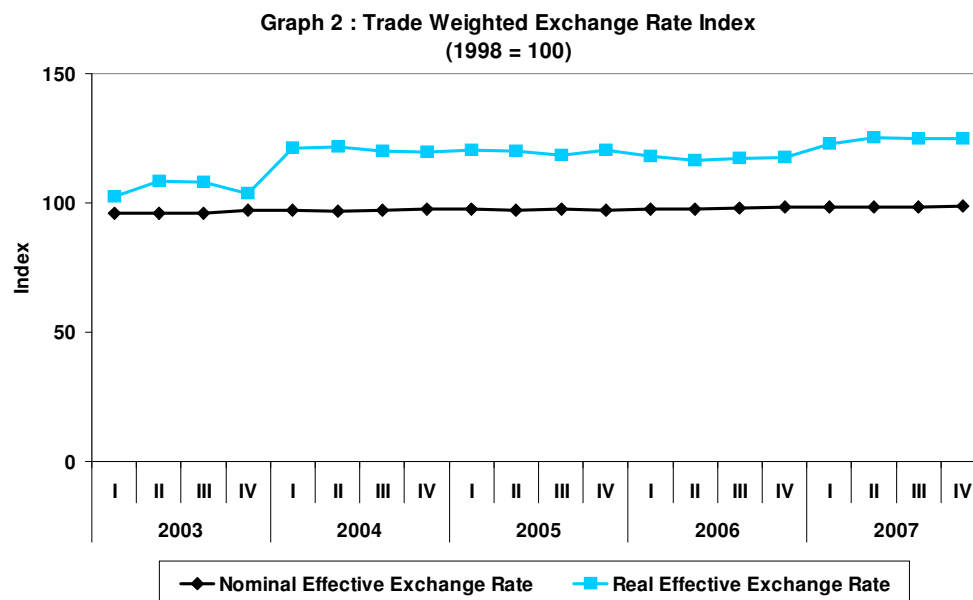
In the December quarter, the Bank of England cut its official cash rate by 0.25 percent to 5.50 percent. The Monetary Policy Committee judged that the balance of risks to the outlook for inflation in the medium term continued to lie on the upside.

In Japan, domestic conditions softened in the December quarter with business sentiment weakening and conditions in the household sector deteriorating. The unemployment rate rose

slightly in the fourth quarter and consumer sentiment fell sharply. Consumer price inflation remained subdued, owing to persistent downward pressures on wages. During the December quarter meetings, the Bank of Japan decided to leave its target for the uncollateralized overnight call rate unchanged at 0.50 percent.

The combination of weaker-than-expected US economic data, the easing by the Fed and ongoing credit concerns stemming from the US' sub-prime mortgage crisis contributed to a sizeable depreciation in the US dollar over the December quarter.

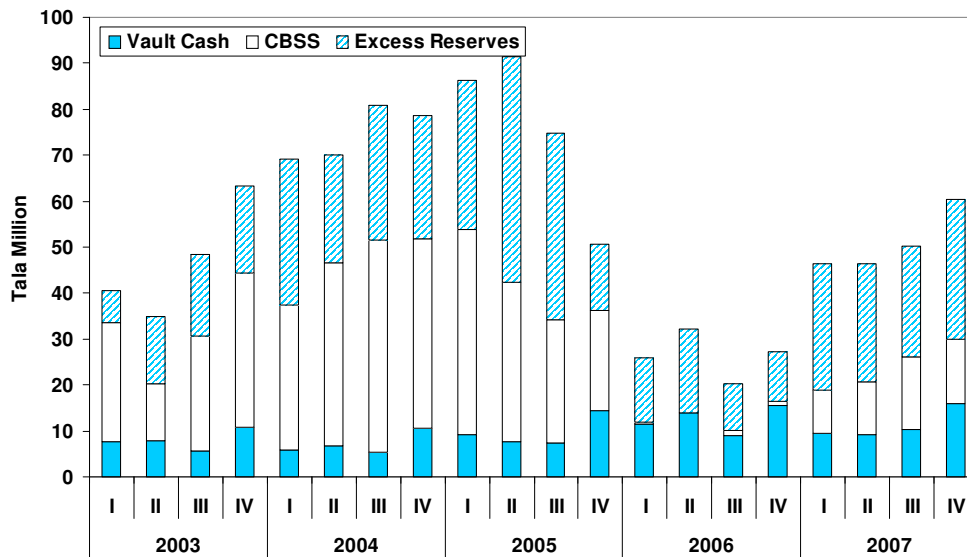
Against the currencies of our major trading partners, the Tala appreciated against the US dollar and the Australian dollar but depreciated against the New Zealand dollar, Euro and the Fiji dollar. The value of the Tala in terms of its nominal index showed an appreciation of 0.03 per cent in the fourth quarter of 2007. Furthermore, since price rises in Samoa were higher than the price rises of Samoa's major trading partners, the real effective exchange rate of the Tala rose 0.18 percent.



b. The Domestic Economy

Monetary conditions in the fourth quarter of 2007 eased with total commercial bank liquidity improving significantly. Assisted by a huge seasonal inflow of foreign exchange in December 2007, total commercial bank liquidity (comprised of their holdings of CBS securities, excess reserves and cash holdings) rose by a substantial 20 percent (\$10.1 million) to \$60.5 million following an 8 percent (\$3.9 million) increase in the previous quarter. (See Graph 3.)

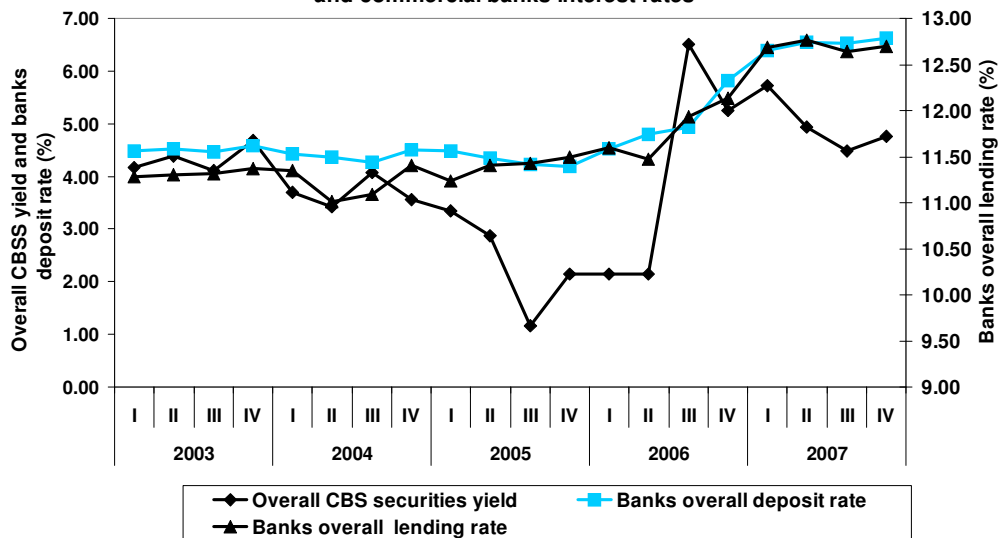
Graph 3 : Commercial Banks Total Liquidity



The Government’s financial operations in the December 2007 quarter registered a quarterly cash surplus of \$5.8 million in contrast to a large cash deficit of \$34.3 million in the preceding quarter. This accumulation of Government funds during the quarter helped maintain the tight stance adopted for monetary policy in fiscal year 2007/08.

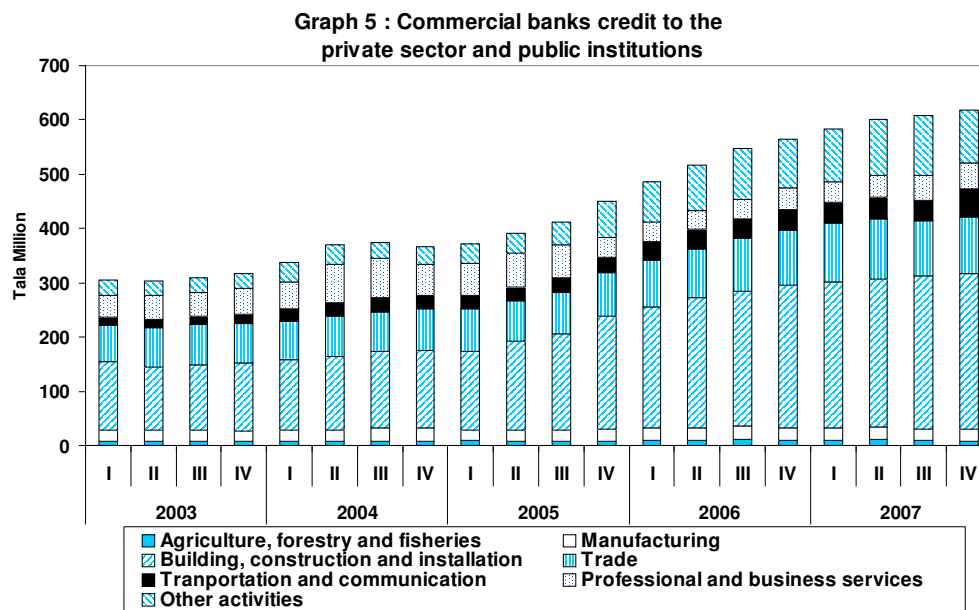
In line with the Bank’s tight monetary policy stance, interest rates rose in the final quarter of 2007. The overall weighted average official interest rate increased to 4.75 percent at end December 2007 from 4.48 percent at end September 2007, pushing up the level of commercial bank lending and deposit rates by 6 points and 10 points to 12.70 percent and 6.62 percent respectively in the same period. (See Graph 4.)

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

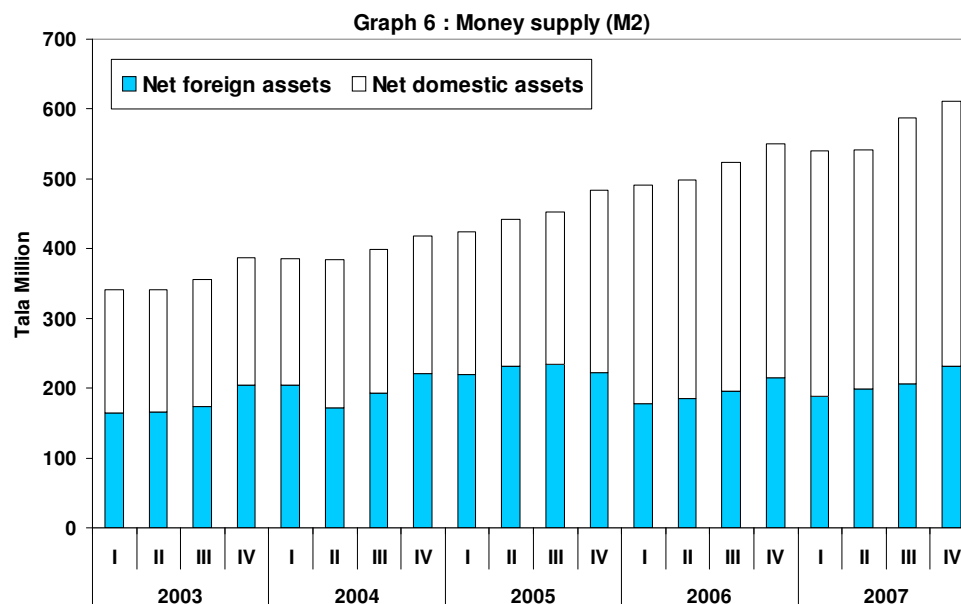


Despite the increased lending rates, strong demand for funds by the private sector and Government Corporations saw bank credit to the private sector and public institutions combined expand by \$9.9 million to \$618.0 million, higher than the \$7.5 million rise in the previous quarter. Private sector credit which rose 2 percent to \$583.1 million was absorbed mainly by the

“Transportation and communication” (up \$13.8 million), “Trade” (up \$6.0 million), “Manufacturing (up \$1.9 million) and “Professional and business services” (up \$0.8 million) sectors during the quarter under review. On an annual average basis, however, the rate of growth of bank credit slowed down to 15 percent from 20 percent at end September 2007, a growth that was in line with the Central Bank’s expectations. (See Graph 5.)

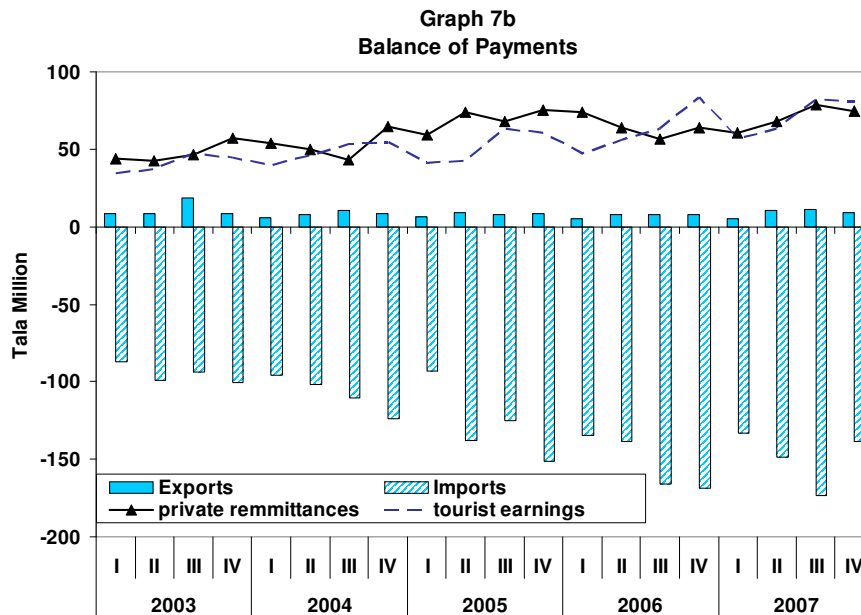
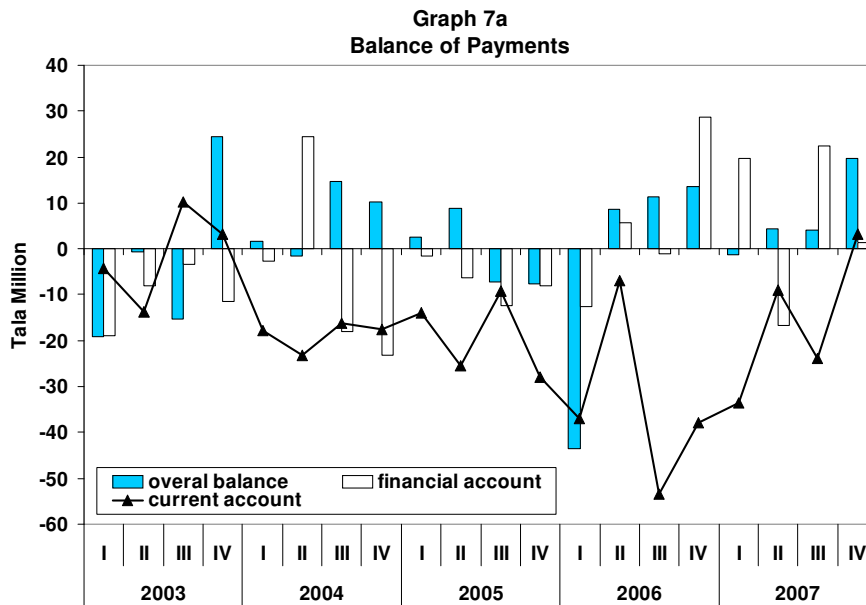


This higher level of bank credit, combined with a 12 percent increase in net inflow of foreign funds raised the level of money supply (M2) by 4 percent (\$24.2 million) in the fourth quarter of 2007. As expected, the annual growth of M2 decelerated to 12 percent from 15 percent in December 2006, in line with the Central Bank’s monetary policy stance. (See Graph 6.)



On the balance of payments, an overall surplus of \$19.6 million was recorded in the December 2007 quarter, compliments of a current account surplus and a smaller outflow in the financial account. (See Graph 7a.) The current account surplus was due largely to a significant 21 percent fall in the merchandise trade deficit, reflecting a 20 percent (\$35.0 million) drop in imports

offsetting decreases in earnings from exports, tourism and private remittances during the quarter. (See Graph 7b.) The improvement in the financial account, on the other hand, was largely a result of a substantial reduction in Government loan disbursements.



All categories of imports declined in the December 2007 quarter, with private sector imports plunging 15 percent (down \$19.3 million), reflecting largely weakened demand for consumer goods, particularly imports of motor vehicles and construction materials. Similarly, petroleum and Government imports shrank 24 percent (\$8.6 million) and 76 percent (\$7.1 million) respectively in the period under review.

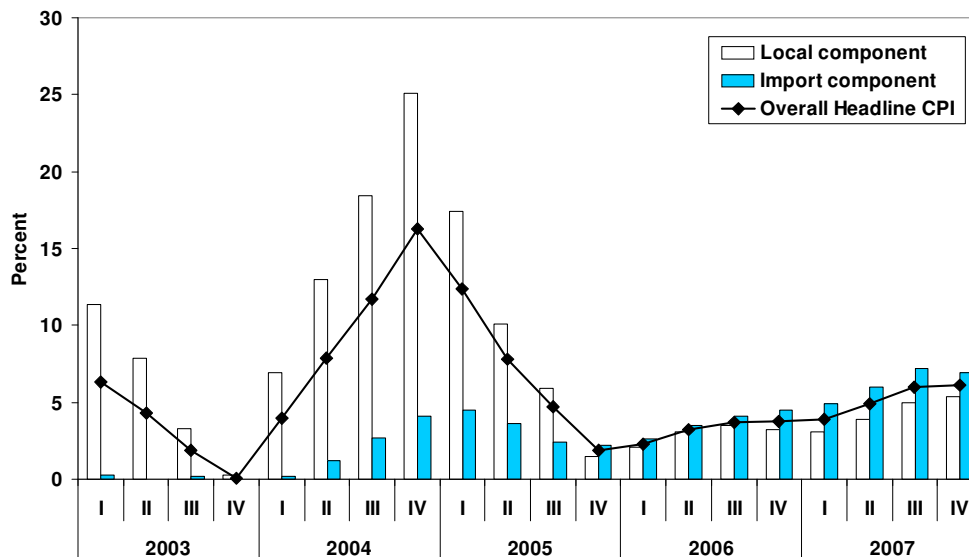
Total export earnings, likewise, fell 16 percent (\$1.8 million) in the fourth quarter of 2007 to \$9.4 million mainly due to a \$1.9 million drop in domestic exports, which outweighed a modest increase in re-exports. Fish exports, which plunged by a substantial 33 percent was largely responsible for the decline in domestic exports, offsetting the gains in other major export

commodities. Revenue from beer, coconut cream and nonu juice grew 35 percent, 43 percent and 12 percent to \$0.2 million, \$0.3 million and \$0.4 million respectively in the quarter under review.

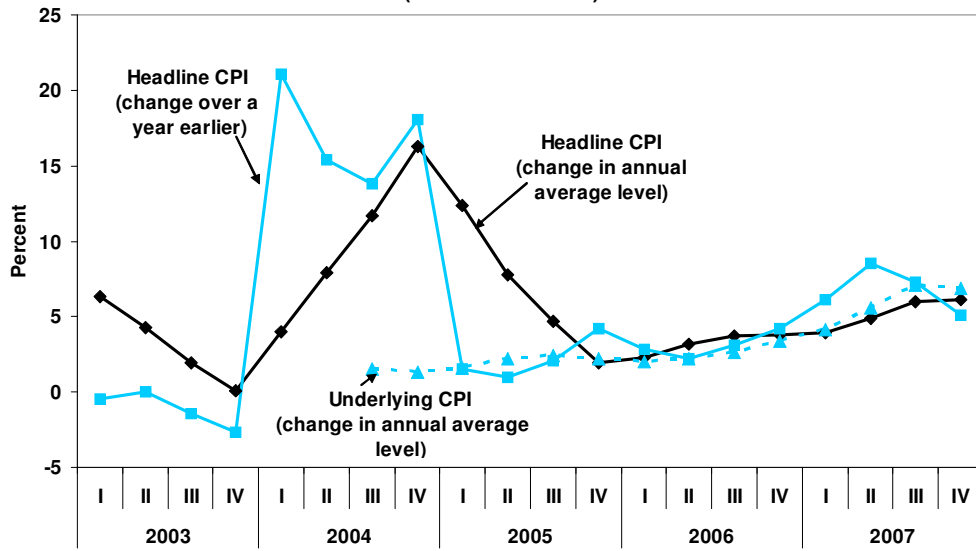
After the highs associated with the South Pacific Games in the previous quarter, tourism earnings declined 2 percent (or \$1.7 million) in the fourth quarter of 2007, following a slight fall in tourist arrivals. Like in the previous quarter, the majority of tourists that visited Samoa in the last quarter of 2007 were those from New Zealand (45 percent), Australia (21 percent) and American Samoa (19 percent). Most of the tourists were here to visit friends and relatives (49 percent) and those who were here for holiday (36 percent). Private remittances as well, fell 6 percent (\$4.6 million) due to a 21 percent drop in remittances for charitable organizations while funds transferred for households were relatively unchanged.

On prices, the average level of headline consumer prices rose 0.3 percent in the December quarter of 2007, to a level 4.9 percent higher than in the same quarter a year earlier. (See Graph 8a.) The higher headline Consumer Price Index (CPI) reflected increased prices in all categories except for the “Food” group. Contributing the most to the higher headline CPI were the 2.3 percent, 1.4 percent and 1.2 percent increases in the “Clothing and Footwear”, “Housing and Household Operation” and “Alcohol and Tobacco”. These sub-indices were largely influenced by external factors, with their import components rising 2.3 percent, 1.7 percent and 3.8 percent respectively. Imported food prices also exerted upward pressure on consumer prices which altogether pushed the overall import component of the CPI further by 1.4 percent during the quarter. By comparison, the local component declined 0.7 percent due entirely to a 2.9 percent fall in local food prices. Consequently, on an annual average basis, the headline rate of inflation edged up to 6.1 percent at end December 2007 from 6.0 percent at end September 2007. The underlying inflation, on the other hand, decelerated to 6.9 percent from 7.1 percent at the end of the previous quarter. But, this rate was significantly higher than the long term target of 3.0 percent. (See Graph 8b.) These higher inflation rates reflected strong demand pressures associated with the growing economy, the supply shocks, the strong New Zealand and Australian dollars and the continuing increase in international oil prices.

Graph 8a : Headline Consumer Price Index



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



III. PRUDENTIAL SUPERVISION

For the quarter ended 31 December 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.

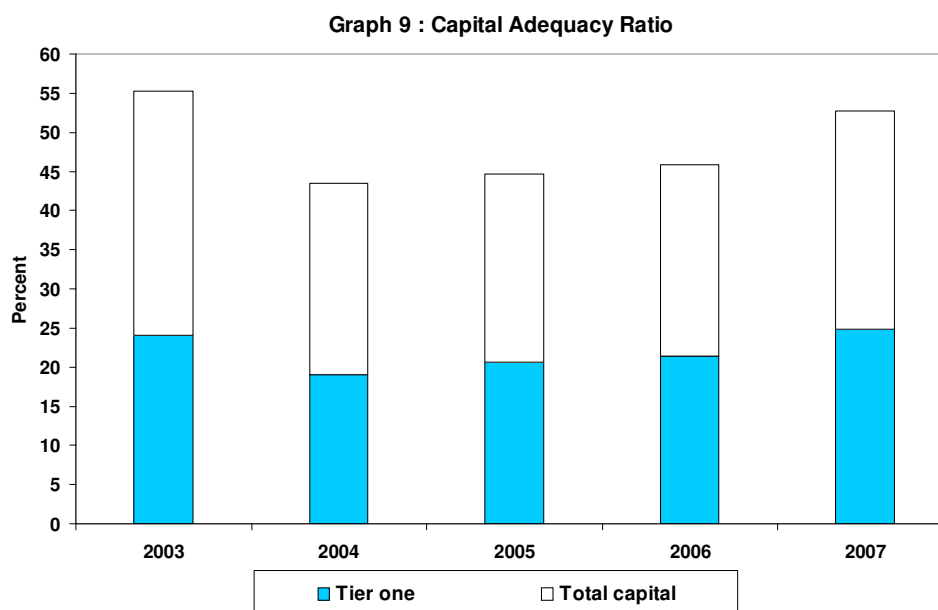
At \$829.3 million, the commercial banks combined assets reflected an increase of 3.6 percent (\$28.5 million) in the December quarter and indicated an annual growth of 13.7 percent (\$99.6 million) when compared to the same period a year earlier. The composition of the commercial banks assets comprised mainly of loans and advances of \$639.9 million (77.2 percent of total assets), cash reserves and deposits with the Central Bank and other banks combined at \$131.0 million (15.8 percent) and fixed assets of \$49.1 million (5.9 percent) respectively.

Total loans and advances of \$639.9 million increased 1.7 percent (\$10.7 million) at the end of the quarter and was 10.1 percent (\$58.7 million) higher than the same period 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 3.8 percent (\$22.7 million) over the previous quarter and thus recording an annual growth rate of 12.2 percent. Time deposits (\$373.9 million) continued to represent the bulk (59.7 percent) of total deposits, while demand deposits (\$178.6 million) and savings deposits (\$74.1 million) accounted for 28.5 percent and 11.8 percent respectively.

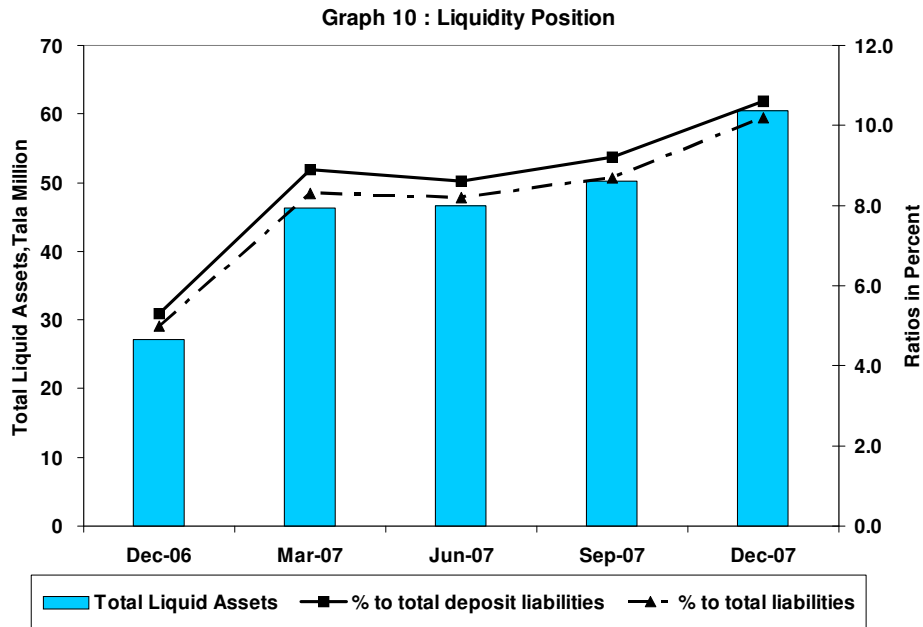
Total contingent and off-balance sheet items went up 17.6 percent (\$16.2 million) to \$108.5 million over the previous quarter, due mainly to increase in unmatured foreign exchange contracts.

The banking system remained strongly capitalized at \$153.2 million, revealing an increase of 4.8 percent (\$7.0 million) over the previous quarter. In relation to the overall level of risk weighted assets, the capital adequacy ratio moved upward from 26.6 percent to 27.9 percent. Tier 1 capital of 24.8 percent increased by 3.9 percent over the September 2007 quarter. (See Graph 9.)



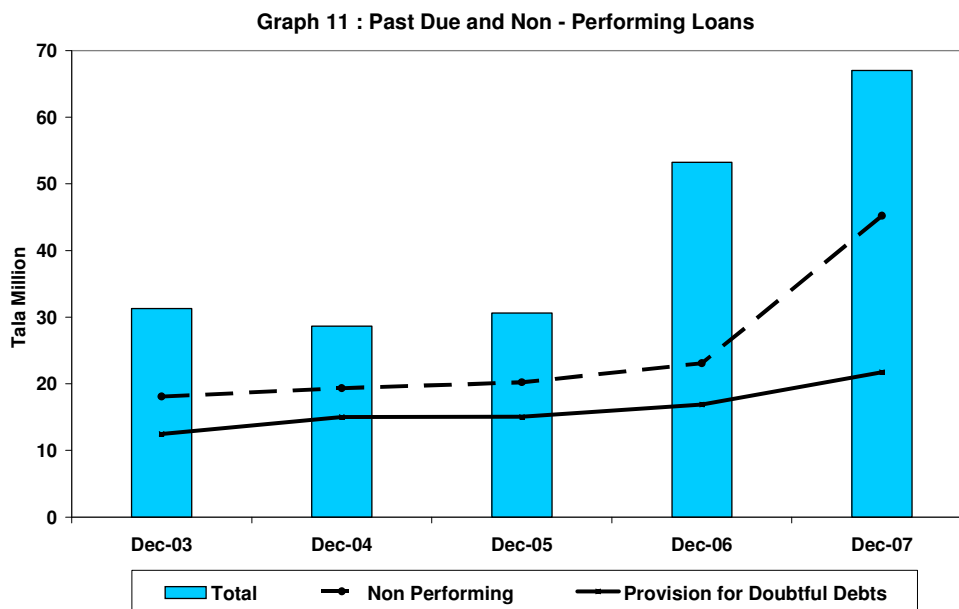
All the banks complied with the Central Bank's minimum capital adequacy requirement (15.0 percent) during the quarter.

The banking system also revealed an improvement in the level of liquid assets by 20.2 percent (\$10.1 million) over the September quarter, and increased by a further 122.4 percent (\$33.3 million) over the year. Total liquid assets stood at \$60.5 million, equivalent to 10.6 percent of total domestic deposit liabilities. The Central Bank Securities of \$13.9 million made up 23.0 percent of total liquid assets in the December quarter. (See Graph 10.)



The combined foreign assets of the commercial banks amounted to \$86.2 million as compared to total foreign liabilities of \$80.5 million. At these levels, it showed a net short exposure position of around \$7.6 million (or 5.0 percent) of total capital.

In the quarter under review, total non-performing loans increased slightly by 1.9 percent (\$0.8 million) to \$45.2 million. Compared to the previous year, non-performing loans increased \$22.1 million. In relation thereto, total provision for bad and doubtful debts of \$21.7 million provided a 48.1 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. (See Graph 11.)



At a combined figure of \$12.9 million, the banking system's pre tax profit level decreased 9.0 percent in the quarter under review when compared to the same period a year earlier. Total net profit after tax, which amounted to \$9.4 million, declined from \$10.1 million recorded a year earlier. At this level, return on average networth and assets stood at 6.9 percent and 1.2 percent respectively. (See Graph 12).

