

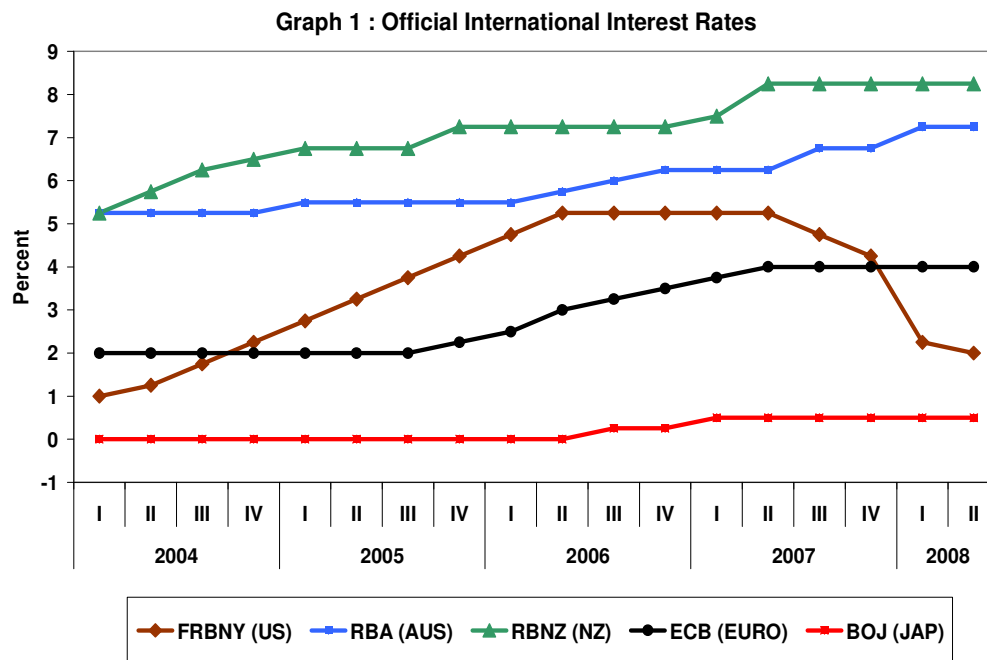
II. OVERVIEW OF ECONOMIC DEVELOPMENTS DURING THE SECOND QUARTER OF 2008.

a. The World Economy

The global economy in the second quarter of 2008 showed further signs of easing as economies began to feel the pinch from record high oil prices and tight monetary conditions. Growth in the US was surprisingly strong over the quarter, whereas in Australia, growth although positive, was somewhat mediocre compared to previous quarters. In Europe, second quarter growth was negative but stagnant in the UK. Japan's growth was negative in the June quarter and in New Zealand it was expected to slow further after the negative print in the first quarter. In spite of slowing growth across the world, inflation remained strong in the June quarter for most economies and in response to this, the central banks upheld their tight monetary stances while others delayed a previously envisaged easing cycle.

A preliminary GDP release for the US showed that the economy grew at an annual rate of 3.3 percent, a strong rebound from the March quarter pace of 0.9 percent. However, the labor market remained weak over the quarter as consecutive monthly job losses led to a rise in the unemployment rate from 5.1 percent to 5.5 percent in the June quarter. Surprisingly, there was a slight pick up in consumer sentiment but it was still weak compared to previous quarters. Personal income posted trivial gains and consumer spending was unexpectedly sound as retail sales steadied over the quarter on strong demand. The decline in housing activity continued as prices and sales of new homes eased lower. Exports remained strong on the dollar's decline and it contributed significantly to the narrower June quarter trade deficit. Amid resilient oil prices, the CPI ticked higher to an annual rate of 5.0 percent in the June quarter from the previous quarter's 4.0 percent.

The Fed lowered its funds rate by 25 basis points in April to 2.0 percent and was on hold from thereon in the June quarter. Despite softening growth, the Fed opted for a hold at 2.0 percent as new record high oil prices posed downside risks to growth and upside risks to inflation. (See Graph 1.)



After an extended period of strong growth, the Australian economy finally began to slow in the June quarter. It grew at an annual rate of 2.7 percent, down from 3.6 percent in the first quarter. A significant moderation in spending and activity were at the reins of this easing. Households' net wealth fell amid declining housing and equity prices, while retail sales fell further following the previous quarter's subdued activity. Consumer sentiment was also weaker. Although the unemployment rate remained low, growth in job numbers was sluggish. Inflation in the June period was unexpectedly strong at an annual rate of 4.5 percent, up from 4.2 percent in the March quarter.

Over the June quarter, the Reserve Bank of Australia (RBA) was on hold at 7.25 percent. Although domestic demand showed signs of easing, upside risks to inflation were key to the RBA's policy decisions.

After contracting 0.3 percent in the March quarter, the New Zealand economy is expected to report another negative growth rate in the June quarter. Demand from the household sector was notably abating as the housing sector underwent a downward correction; sales volumes were down and prices were declining in many areas. The resulting negative wealth effects compounded other headwinds facing the household sector. Growth in the labour market was sluggish and the unemployment rate rose to 3.9 percent from 3.7 percent. Measures of consumer and business confidence were dismal as food prices rose, oil prices surged higher and the strengthening currency put upward pressure on import prices. In the midst of rising food and fuel prices, inflation was 1.5 percent in the quarter, taking the annual CPI rate to 4.0 percent in June quarter from 3.4 percent in March.

Over the June quarter, the Reserve Bank of New Zealand (RBNZ) kept its overnight cash rate on hold at 8.25 percent, despite mounting signs of slower growth. Upside risks to inflation remained a priority to the RBNZ and until price pressures showed considerable signs of abating, downside risks to growth were temporarily overlooked.

In the Euro area, growth in several economies within the Euro region was already receding. Euro-land GDP fell 0.2 percent in the quarter after expanding 0.8 percent in the March quarter. The labour markets in the Euro region remained reasonably tight, with the unemployment rate still close to 7.2 percent. Money and credit growth were also robust despite the credit crunch of 2007. However, overall consumer confidence was still very weak. The annual inflation rate for the Euro region was 4.0 percent in the quarter, up from 3.6 percent in March.

Over the June period, the European Central Bank (ECB) left its official interest rate at 4.0 percent. Risks to inflation amid soaring fuel prices and despite signs of slowing growth, was also the key reason behind the ECB's decision to leave its interest rate unchanged.

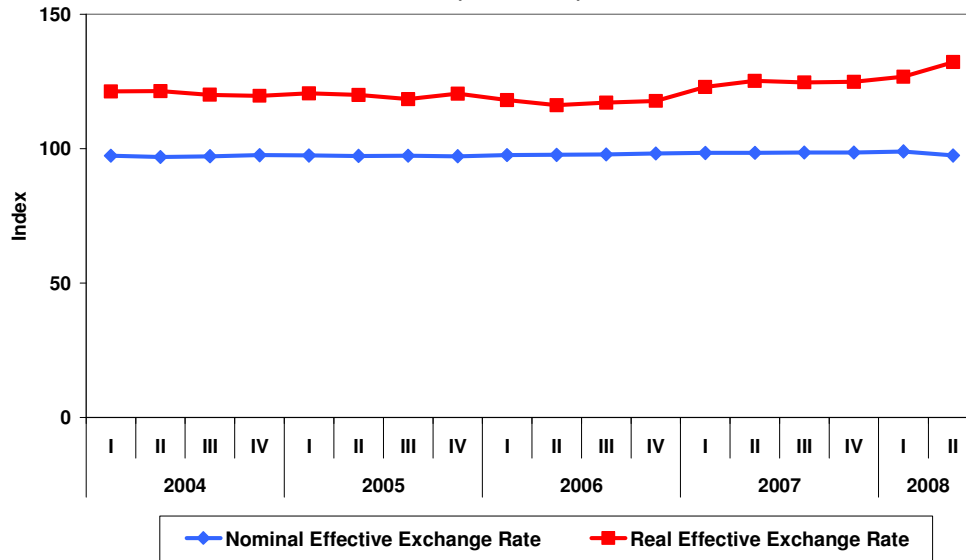
The United Kingdom expanded only 0.2 percent in the June quarter, mainly due to a 0.4 percent decline in manufacturing and a 0.7 percent drop in construction. Forward looking indicators for the services, factory and construction sectors were weak; suggesting that the growth pulse will continue to slow. Employment growth continued to soften, with the unemployment rate now close to 5.5 percent. Inflation in the UK was at an annual rate of 3.8 percent in the quarter, up from 3.3 percent.

In April, the Bank of England (BOE) reduced its official interest rate to 5 percent by 25 basis points and from thereon, remained on hold. Signs of easing growth early in the June quarter prompted the rate cut but risks to inflationary pressures were still evident amid rising oil prices, hence the BOE's decision to remain on a tight monetary stance.

In Japan, growth in the second quarter decelerated 0.6 percent, from a 0.8 percent growth in the first quarter. Japan’s housing activity continued to soften amid falling dwelling investments. Private consumption also fell in the June period. Sentiment among large manufacturing businesses regarding outlook on business conditions were less gloomy compared to the previous quarter. However, forward looking indicators of business activities were somewhat subdued as global growth continued its downtrend. Inflation in Japan accelerated again in June to an annualised rate of 2.0 percent from 1.3 percent in the previous month. Over the June quarter, the Bank of Japan (BOJ) continued to hold its official interest rate at 0.5 percent.

In the foreign exchange markets, the US dollar continued on its depreciating trend against most major currencies. This brought about a continued strengthening of the Tala against the US dollar but also a period of extended depreciation against the currencies of our major trading partners; the New Zealand dollar, the Australian dollar, the Fijian dollar and the Euro. In terms of the Tala’s nominal index, the overall performance of the Samoan currency against the currency basket was a 1.6 percent depreciation in the quarter under review. In real terms, the real effective exchange rate indicated that the Tala appreciated by 4.32 percent and this was because prices in Samoa continued to rise faster than those of our major trading partners.

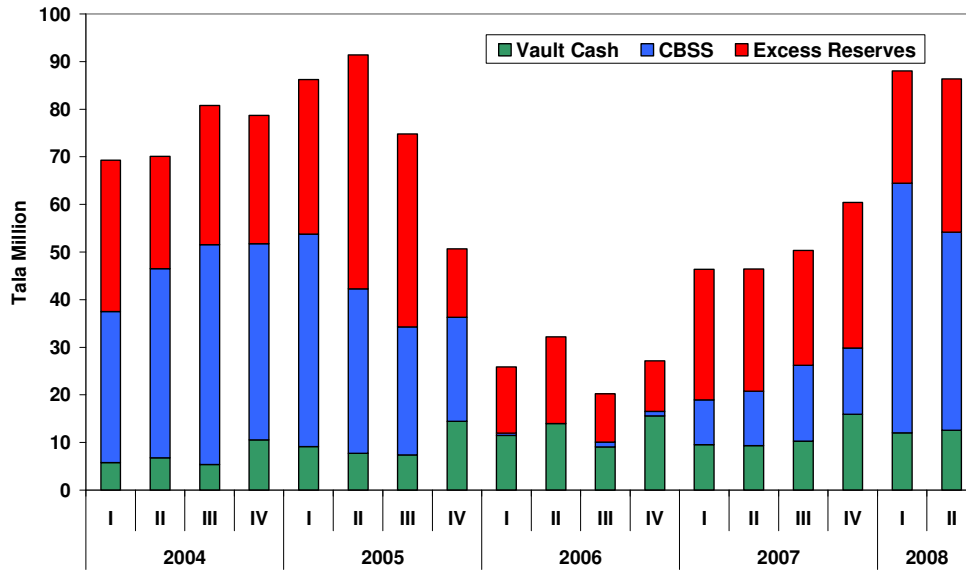
**Graph 2 : Trade Weighted Exchange Rate Index
(1998 = 100)**



b. The Domestic Economy

After a continuous build-up in the last two years, total commercial bank liquidity contracted a little in the June 2008 quarter. Comprising of cash holdings, excess reserves and investments in CBS securities, total commercial bank liquidity fell 2 percent or \$1.7 million in the June 2008 quarter, following a substantial \$27.6 million increase in the previous quarter. At \$86.4 million, however, total commercial banks’ liquidity at end June 2008 remained strong and plentiful. The slight reduction reflected a 21 percent decrease to \$41.6 million in commercial banks’ holdings of CBS securities that more than offset improvements in excess reserves (up 37 percent to \$32.2 million) and cash holdings (up 5 percent to \$12.6 million.) (See Graph 3.)

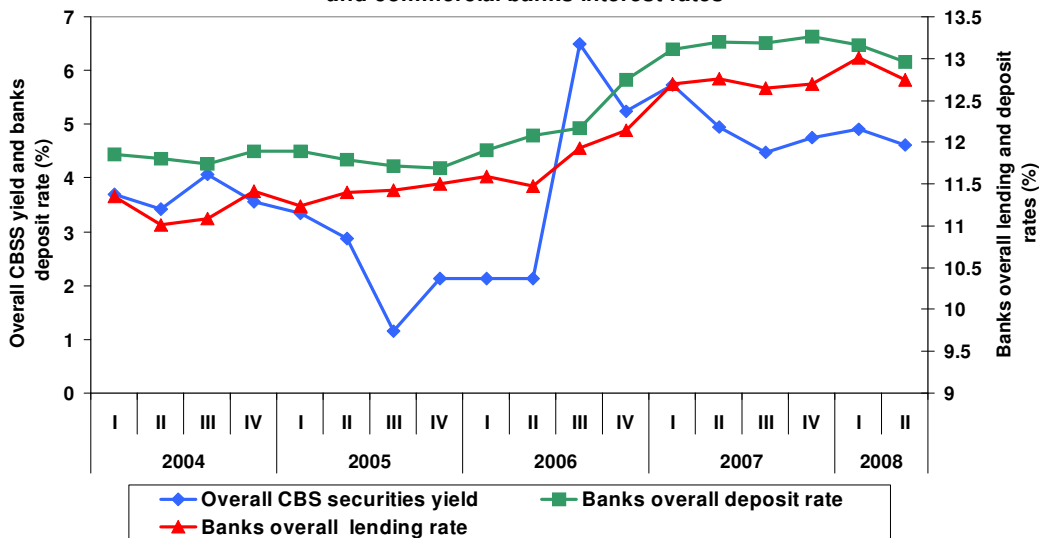
Graph 3 : Commercial Banks Total Liquidity



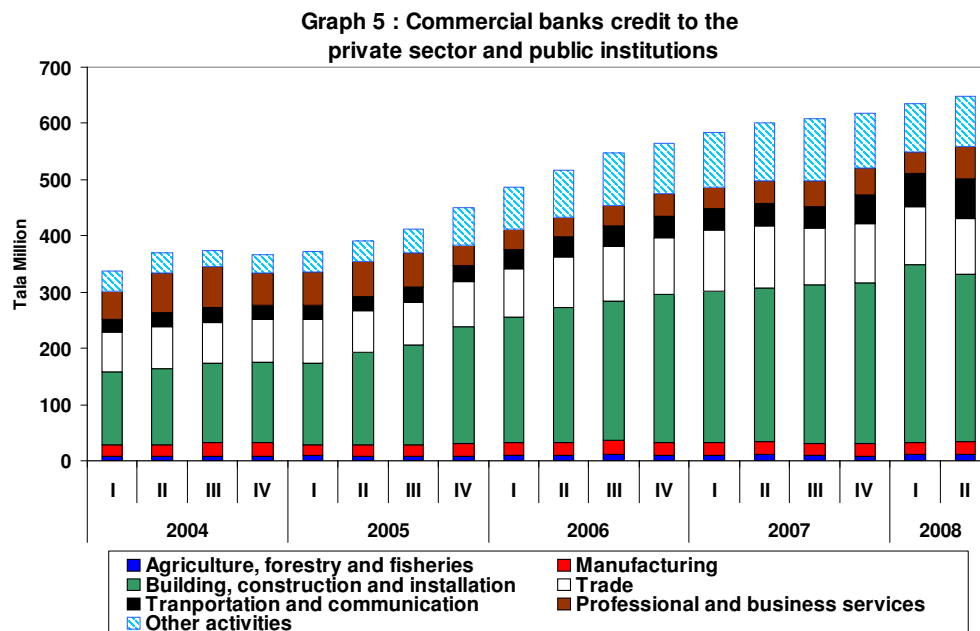
Monetary statistics showed that Government recorded a cash deficit vis-à-vis the monetary system in the June quarter of 2008, softening slightly the tight monetary policy stance that was pursued in the 2007/2008 financial year. In the event, a net drawdown of Government deposits with the monetary system led to Government’s financial operations closing off the fiscal year with a quarterly cash deficit of \$4.2 million, after recording a cash surplus of \$20.5 million in the previous quarter.

The high level of liquidity in the banking system contributed to interest rates declining in the second quarter of 2008. Lower investments in short term CBS securities than in the March 2008 quarter saw the overall weighted average official interest rate decrease 29 basis points to 4.62 percent at end June 2008 from 4.91 percent at end March 2008. Corresponding to this official rate trend, commercial bank interest rates eased off from their levels in the previous quarter, albeit at different magnitudes. While the average lending rate fell 27 basis points to 12.74 percent, those for deposits dropped by a larger 32 basis points to 6.15 percent. In the event, the commercial bank’s interest rate spread edged up to 6.59 percent from 6.54 percent in the previous quarter. (See Graph 4.)

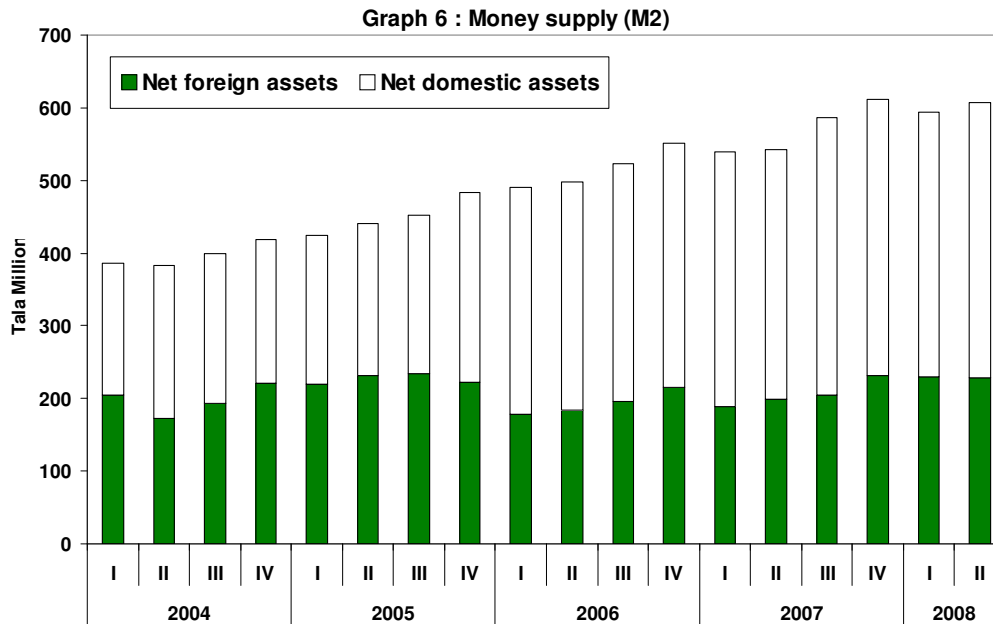
Graph 4 : Overall yield on CBS securities and commercial banks interest rates



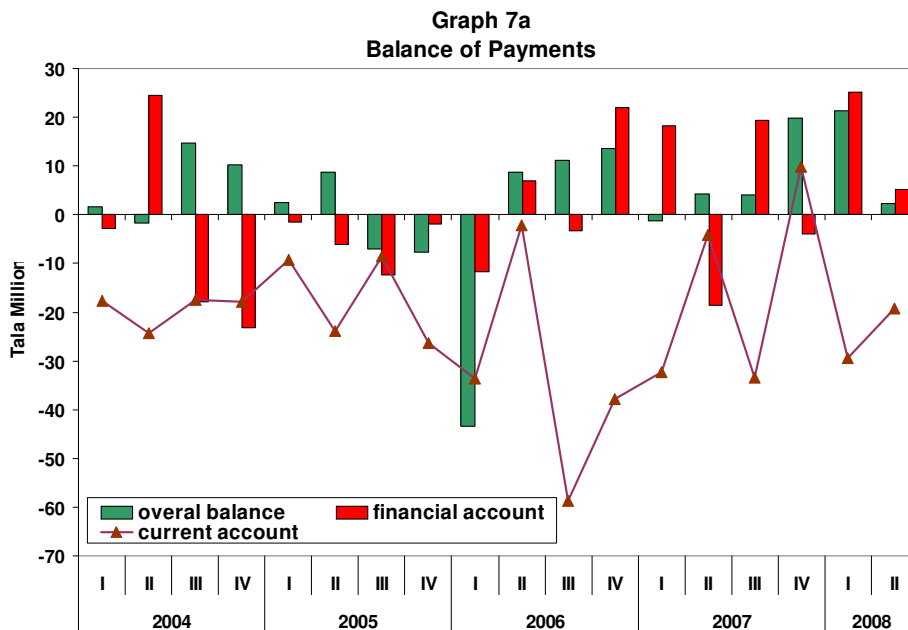
As banks started to grant loans towards the low end of their interest rate spectrum, demand for credit by the private sector and Government corporations strengthened, as indicated by a 2 percent (\$13.5 million) expansion to \$648.4 million in bank credit to the private sector and public institutions combined, on top of a larger \$16.8 million growth in the March 2008 quarter. The private sector demand for commercial banks' credit in the June quarter was driven by lending to "Professional and business services" (up \$20.9 million to \$57.9 million), "Other activities" which largely reflected small loans to individuals (up \$1.6 million to \$48.7 million) and "Electricity" (up \$1.3 million to \$7.7 million) sectors. Similarly, further credit were extended to "Transport and communication" (up \$1.1 million to \$37.5 million), "Manufacturing" sectors (up \$1.0 million to \$22.3 million) and "Agriculture" (up \$0.9 million to \$9.7 million) sectors. Partially offsetting these increases were reductions in claims on "Building and construction" (down \$18.7 million to \$297.7 million) and "Trade" (down \$4.8 million to \$99.3 million). (See Graph 5.) On an annual average basis, however, the rate of growth of commercial bank loans outstanding slowed down to 10.8 percent at end June 2008, from 12.6 percent at end March 2008.



Underpinned by this higher level of bank credit and Government's cash deficit with the monetary system, net domestic assets grew 4 percent (\$16.2 million) in the June quarter of 2008, offsetting a 1 percent (\$3.3 million) drop in net foreign assets to push total money supply (M2) up 2 percent (or \$13.0 million) to \$608.3 million. (See Graph 6.)

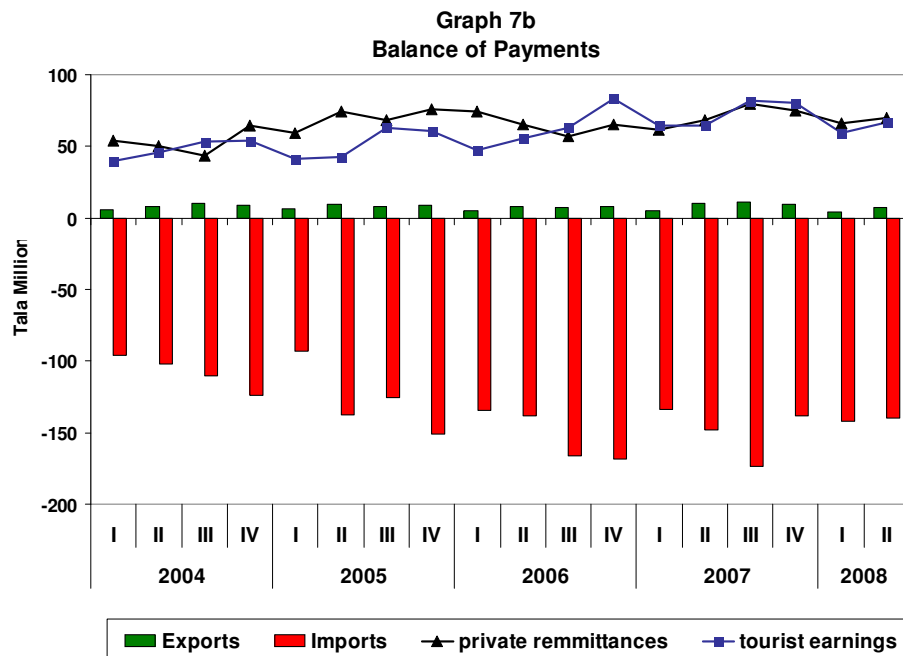


On the balance of payments, the June 2008 quarter recorded an overall surplus of \$2.4 million, on the back of a larger \$20.5 million surplus in the March 2008 quarter, compliments of an inflow of funds in the financial account and assisted by a reduction in the current account deficit. (See Graph 7a.)



The improvement in the current account balance reflected a reduction in the merchandise trade deficit, higher tourism earnings and increased private remittances during the quarter under review. (See Graph 7b.) After dropping in the March 2008 quarter, foreign exchange revenue from tourism increased 13 percent (or \$7.7 million) compliments of a seasonal 21 percent jump in tourist arrivals which offset an 8 percent reduction in average tourist expenditure. Of the increased number of tourists in the three months to June 2008, the majority were, as usual, those from New Zealand (42 percent), American Samoa (22 percent) and Australia (17 percent). An equal proportion of these travelers in the June 2008 quarter were tourists who were here on holiday and those who came here to “visit friends and relatives” (41 percent each). Inflow of

funds from private transfers rebounded 6 percent (\$4.1 million) in the quarter under review, following a 10 percent increase in household family remittances outweighing a 10 percent drop in remittances for charitable organizations.

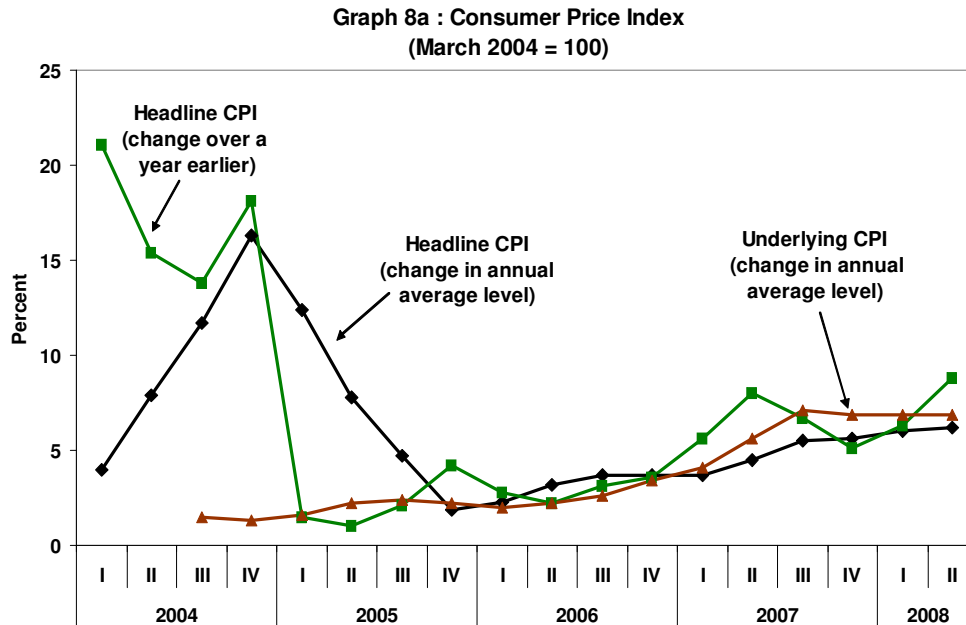


Similarly, the merchandise trade balance improved from the first quarter of 2008, as a 71 percent (\$3.0 million) growth in export earnings and a 1 percent (\$2.1 million) drop in imports narrowed the merchandise trade deficit by 4 percent (\$5.0 million). Underpinning the drop in import payments to \$139.8 million in the June quarter of 2008 was a 29 percent (or \$12.3 million) decline in petroleum products, reflecting an absence of petroleum imports in April 2008. Private sector imports, on the other hand, grew 10 percent (or \$9.8 million) while Government imports edged up by \$0.4 million in the quarter under review.

The main contributors to the increase in total export revenue to \$7.2 million in the second quarter of 2008 was a \$2.9 million boost in domestically produced exports and a smaller \$0.1 million rise in re-exports. The higher domestically produced exports in the three months to June 2008 mainly reflected improved export volumes of some major commodities. The main drivers were a seasonal increase in export receipts for fresh fish, which rebounded more than two fold to \$3.1 million, a more than doubled level of nonu juice to \$1.0 million and a 35 percent increase to \$0.9 million in beer exports. Other commodities to record gains in the quarter under review were coconut cream (up 17 percent to \$0.5 million), taro (up 18 percent to \$0.2 million), coconut oil (up 17 percent to \$54 thousand), soft drinks (up 19 percent to \$76 thousand) and 'other exports' (up 77 percent to \$99 thousand). On the downside were nonu fruit (down 55 percent to \$18 thousand) and coconut (down 12 percent to \$0.1 million). There were no exports of cigarettes and timber in the quarter under review.

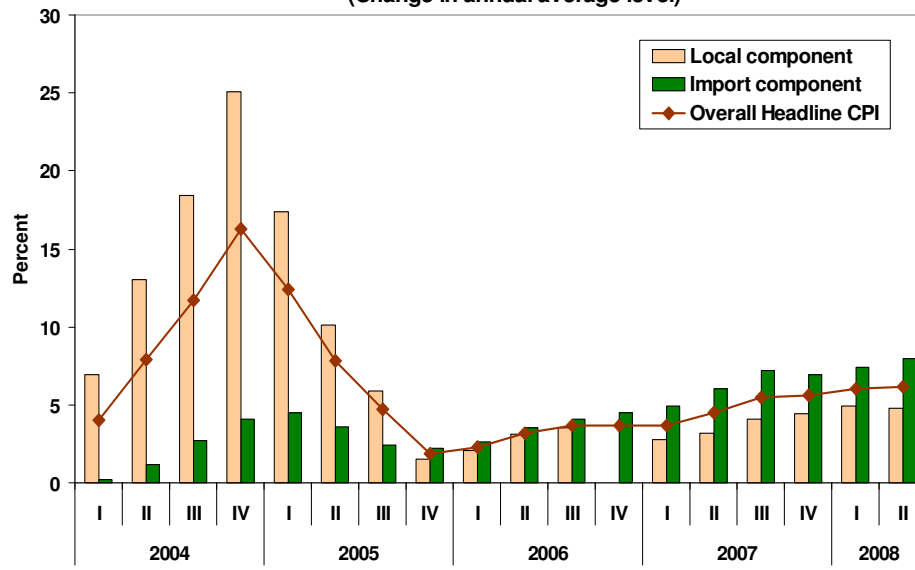
The CPI data for the June quarter confirmed the significant influence of developments in the international commodity markets on domestic inflation so far in 2008. The average level of the headline CPI, which was 7.2 percent higher than in the same quarter last year, rose 2.1 percent in the quarter under review reflecting a 4.5 percent increase in the overall import component and a modest 0.1 percent rise in the overall local component when compared to the March 2008 quarter. With this higher average price level over the year, the headline inflation rate, on an annual average basis, increased to 6.2 percent at end June 2008, from 6.0 percent at end March 2008 and 4.5 percent at end June 2007. On the other hand, the annual underlying inflation rate at 6.9 percent

remained steady in the June 2008 quarter but was higher than the 5.6 percent inflation rate a year earlier. (See Graph 8a.)



Soaring commodity prices in the international markets, particularly those of food and oil, have had a huge impact on inflationary developments in the quarter under review. Further significant increases in prices of imported food (such as rice, butter and chicken leg quarters), kerosene, petrol and diesel added to the high quarterly CPI data, as reflected by expansions in the import components of “Transport and Communication” (up 15.9 percent), “Housing and Household Operations” (up 4.4 percent) and “Food” (up 3.5 percent) sub-groups. For the overall local component of the headline CPI, while the “Housing and Household Operations” sub-group edged up 3.1 percent as electricity costs jumped significantly due to two fuel surcharges (totaling around 10.8 percent) added onto the base rate, it was partially offset by falls in local food prices at the Fugalei Market as food crops improved during the June quarter of 2008. Consequent to these price movements in the quarter under review, the overall import and local components of the headline CPI recorded annual average increases of 8.0 percent and 4.8 percent respectively, compared to 7.4 percent and 4.9 percent in that order in the previous quarter. (See Graph 8b.)

Graph 8b : Headline Consumer Price Index
(Change in annual average level)



III. PRUDENTIAL SUPERVISION

For the quarter ended 30 June 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 showed a slight reduction over the previous quarter.

At \$879.3 million, the commercial banks combined assets reflected an increase of 3.1 percent (\$26.8 million) in the June quarter and indicated an annual growth of 13.7 percent (\$106.0 million) when compared to the same time a year earlier. The composition of the commercial banks assets comprised mainly of loans and advances of \$669.2 million (76.1 percent of total assets), cash reserves and deposits with the Central Bank and other banks combined at \$169.2 million (19.2 percent) and fixed assets of \$52.9 million (6.0 percent) respectively.

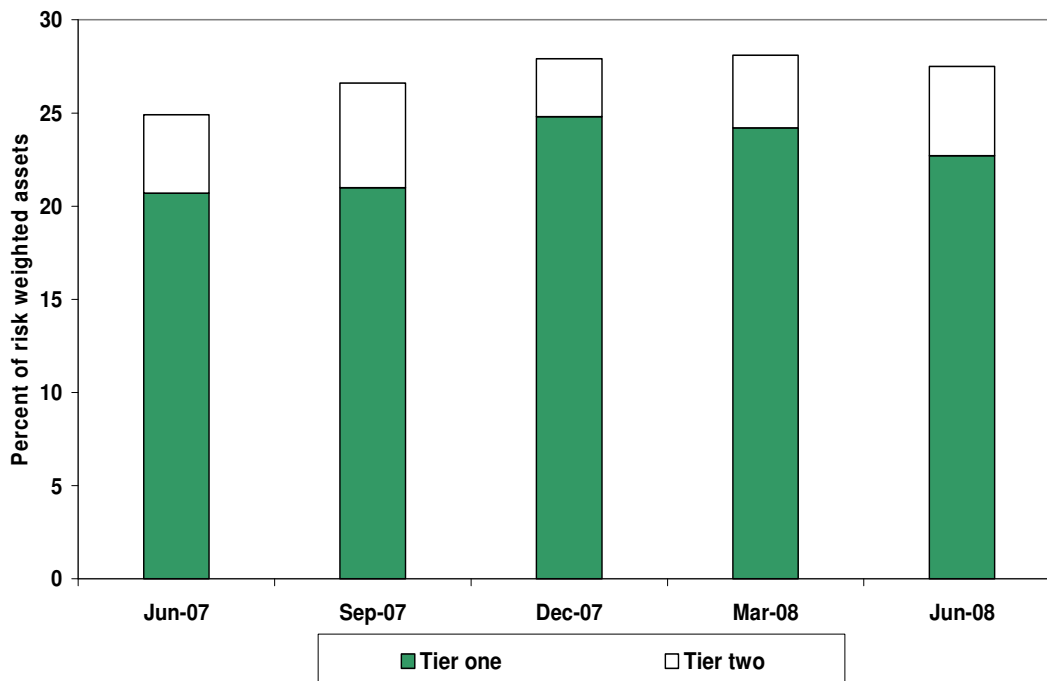
Total loans and advances of \$669.2 million increased by 2.4 percent (\$15.9 million) at the end of the quarter and further rose by 13.7 percent (\$106.0 million) over the same time a year earlier. The strong growth in loans and advances was attributed mainly to loans to private businesses and households and Government.

Total deposit liabilities showed an increase of 2.5 percent (\$16.4 million) over the previous quarter and thus recording an annual growth rate of 12.7 percent (\$74.5 million) respectively. Time deposits (\$395.5 million) represented 59.9 percent of total deposits, demand deposits (\$190.8 million) accounted for 28.9 percent while savings deposits (\$74.0 million) made up 11.2 percent of total deposit liabilities.

Total contingent and off-balance sheet items increased by 17.9 percent (\$15.6 million) to \$103.1 million over the previous quarter, due mainly to increases in unmatured foreign exchange contracts.

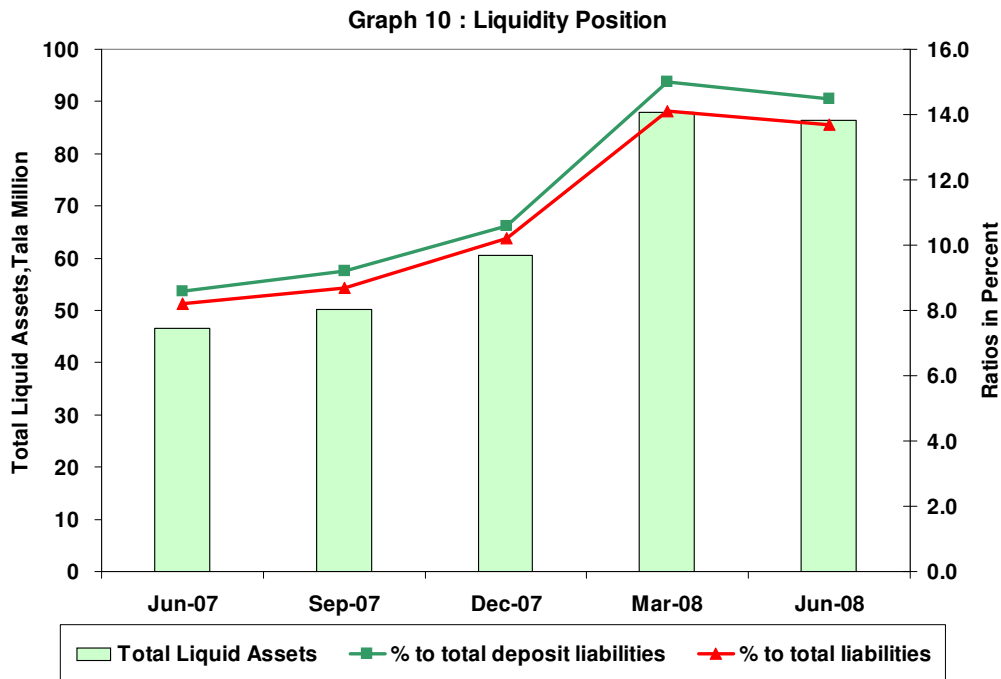
The banking system remained strongly capitalized at \$155.9 million, revealing an increase of 2.2 percent (\$3.3 million) over the previous quarter due mainly to the banks profitable performance throughout the period. In relation to the overall level of risk weighted assets, the capital adequacy ratio was slightly down from 27.6 percent to 27.5 percent. Tier 1 capital of 22.7 percent decreased by 1.1 percentage points over the March 2008 quarter. (See Graph 9.)

Graph 9 : Capital Adequacy Ratio



All the banks were well above the Central Bank's minimum capital adequacy requirement of 15.0 percent at the end of the quarter under review.

The banking system also recorded a slight drop in the level of liquid assets by 1.9 percent (\$1.7 million) from the previous quarter and an increase of 85.1 percent (\$39.7 million) when compared to the past twelve month's level. Total liquid assets stood at \$86.4 million, equivalent to 14.5 percent of total domestic deposit liabilities. Total Central Bank Securities, of \$41.6 million, made up 48.2 percent of total liquid assets at the end of the quarter under review. (See Graph 10.)

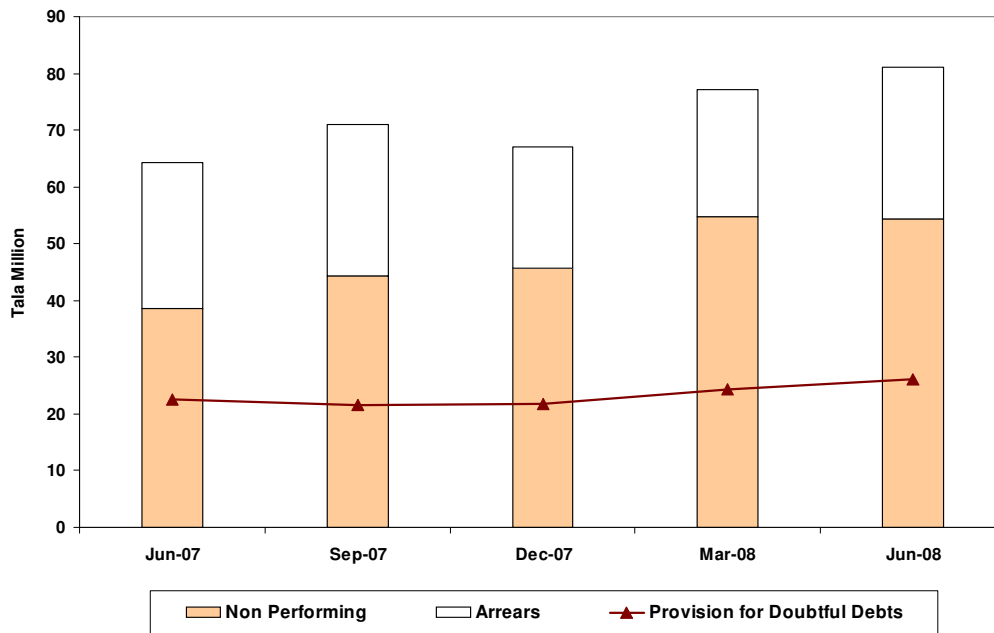


The combined foreign assets of the commercial banks amounted to \$104.7 million as compared to total foreign liabilities of \$98.6 million. At these levels, it showed a net long exposure position of around \$7.1 million (or 2.3 percent) of total capital.

The overall level of problem loans recorded a slight decrease of 1.0 percent (\$0.6 million) to \$54.3 million. As compared to the prior year, however, the level of non performing loans registered a marked increase of \$15.7 million respectively. In relation thereto, total provision for bad and doubtful debts of \$26.2 million provided a 48.2 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 3.9 percent respectively.

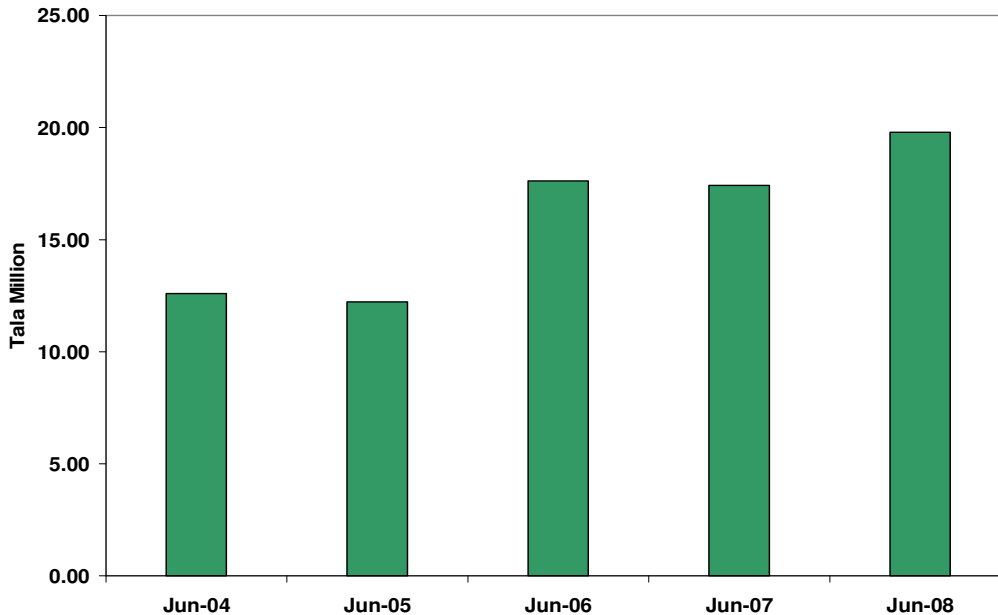
The Central Bank continued to monitor closely the banks performances towards reducing their levels of arrearages and non-performing loans, which require them to be extra vigilant in their approaches towards asset quality. Equally important, is the need for the banks to ensure that adequate provisions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

Graph 11 : Past Due and Non-Performing Loans



At a combined figure of \$25.6 million, the banking system’s pre tax profit level increased by 8.1 percent in the quarter under review when compared to the same period a year earlier. Total net profit after tax amounted to \$19.8 million, up from \$17.4 million recorded a year earlier. At this level, the return on average network and assets stood at 14.0 percent and 2.4 percent respectively. (See Graph 12.)

Graph 12 : Profitability



For the period under review, total operating expenses represented 67.4 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.

IV. SOARING OIL PRICE AND INFLATION

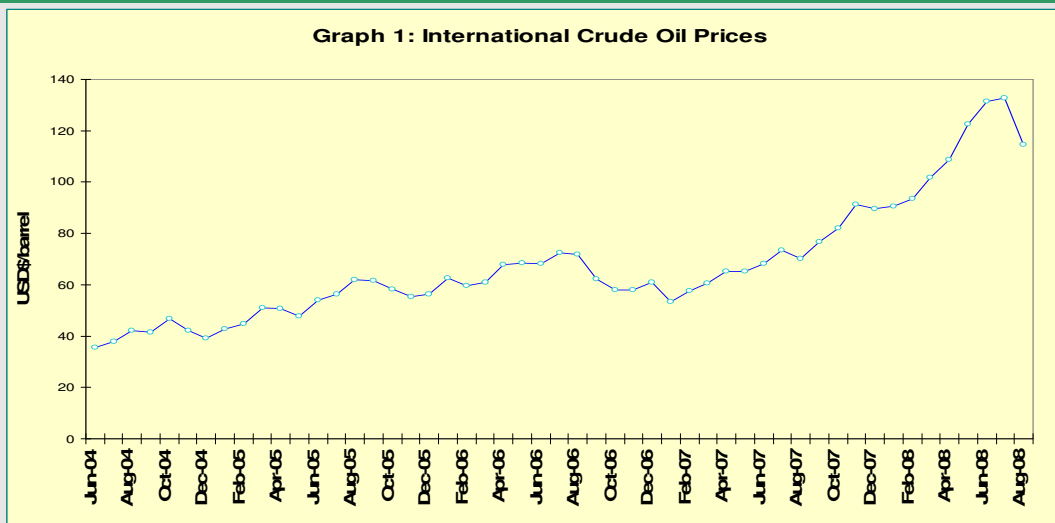
Crude oil is the world's most actively traded commodity with its price determined in the international commodity market. It is refined into a variety of products such as unleaded petrol, gasoline, kerosene and lubricants, all of which are the major sources of energy that drives the world today.

The price of a barrel of crude oil is predominantly influenced by the economic fundamentals of supply and demand, and to a certain extent, speculation by market traders. Generally, when there is growth in the global economy, demand for oil increases and its price rises too unless supply also increases. On the other hand, when there is an economic slowdown, oil prices fall as demand weakens. Similarly, if there are fears of supply disruptions in the future due to events like civil war, terrorism threats or labor strikes in major oil-producing nations, buyers will often try to stock-up oil inventories in advance. This unusual increase in demand may also lead to a rise in prices.

The largest supplier of crude oil in the world is the Organisation of Petroleum Exporting Countries (OPEC), an association of oil producing nations that was set up in 1960 to influence oil prices by controlling supply. At present there are thirteen (13) member countries of OPEC with Indonesia leaving the association when its membership expires later this year. Saudi Arabia is the largest oil producing nation, followed by Iran, Venezuela and Iraq. Other non-OPEC countries such as Russia and Canada are also significant suppliers of crude oil. The price of a barrel of crude oil is quoted in US dollars. In 2000, OPEC adopted a price band between USD\$22-\$28 per barrel, which meant that if oil prices were below USD\$22 per barrel, production quotas would be cut back to push prices upwards. Conversely, if prices went above USD\$28 per barrel, then OPEC would increase its supply. This price band was abandoned in 2005 when crude oil prices started to rise sharply, which coincided with the plunge in the value of the US dollar against leading currencies. Since then, there has been no official price target. When members meet, they would try to coordinate future production with their predictions for demand. At their last meeting on 9 September 2008, OPEC decided to stick to its September 2007 quota of 28.8 million barrels of oil per day to head off their declining price of oil.

A persistent increase in oil prices has profound effects on economic growth and the inflation rate. Oil is the main source of fuel in most countries. Consequently, as the price of oil goes higher, the cost of producing goods and services is ultimately passed onto consumers through higher prices for such products and services. And, for a small open economy such as Samoa, which now mostly imports its food and fuel, the higher prices of these imported goods are unavoidably passed on to its local consumers. And, with increased cost of locally-produced goods and services associated with the rise in oil prices, the inflation rate will be substantially higher. These are impacts that will eventuate if oil prices remain high for a long period. The last half of 2007/2008 was evident of this scenario when sustained buoyancy in the prices of crude oil and food contributed to higher headline inflation rates around the world. The huge ramifications of these commodity price increases were particularly felt in emerging economies where the headline inflation rate rose more sharply due to a combination of strong demand growth and a greater weight of energy and food in consumption baskets or the CPI.

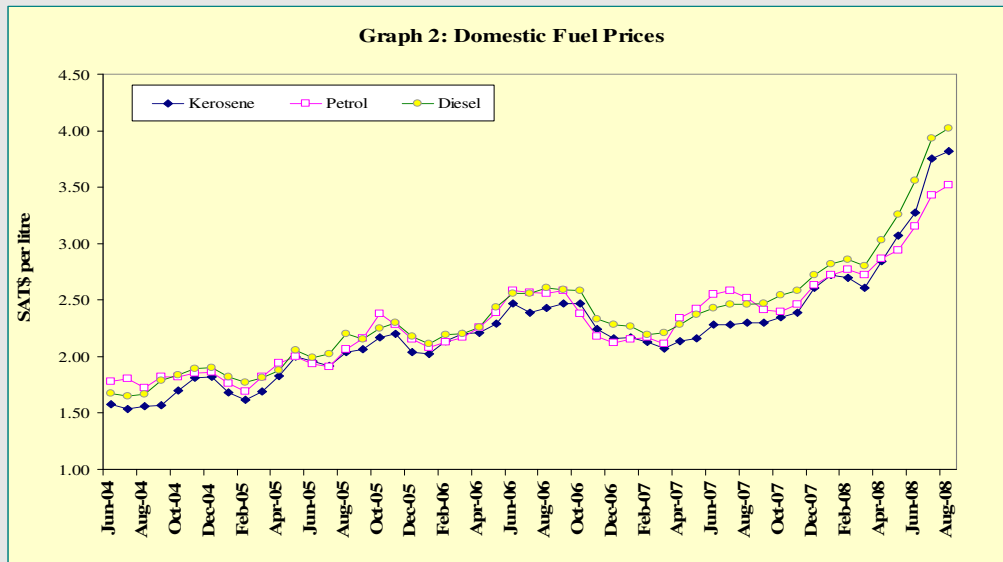
Since March 2005, when the price of crude oil surpassed the USD\$50 mark, a lot of factors have come into play, taking the cost of a barrel of crude oil to a high of USD\$147 on July 2008. (See Graph 1.)



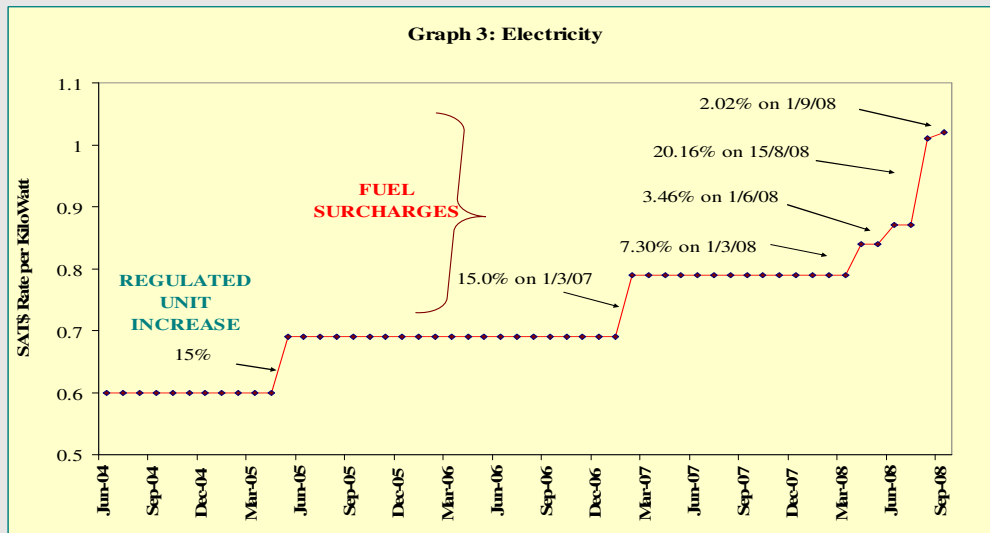
Prior to August 2008, the weak US dollar, which is the currency used in trading oil internationally, has encouraged financial investors to invest in oil contracts. The vigorous involvement of speculators in the oil market prompted OPEC to withhold increasing any oil production in the market when prices surged above USD\$100 per barrel for the first time in January 2008. Supply concerns were another factor with fears about the security of oil inventory in major oil-producing countries. Much of the world's oil is found in volatile regions, such as the Middle East, and with political instability persisting in countries such as Iraq, Iran and Nigeria; fears remained about frequent and unpredictable disruptions to supplies. World demand for oil have also edged up with the fast growing economies of China and India exerting pressure given their relatively intense demand for oil. In July 2008, the average spot price for a barrel of crude oil reached a new high of USD\$132.83, 80 percent higher than in July 2007 when the spot price for a barrel cost USD\$73.60¹.

In Samoa, refined oil directly affects two sub-groups within the CPI basket with a total weight of only 3.3 percent. Kerosene contributes around 0.7 percent and is included under the "Housing and Household Operations" sub-group, while unleaded petrol, diesel and engine oil, have a combined weight of 2.5 percent and are classified under the "Transport and Communications" sub-index. Petrol prices increased by an average 15 percent to SAT\$2.68 per litre in 2007/2008, directly contributing around 0.3 percentage points to the annual headline inflation rate. Diesel prices rose 17 percent to SAT\$2.80 per litre and directly contributed 0.1 percentage points while kerosene prices surged an average 16 percent to SAT\$2.62 per litre, and added 0.1 percentage points directly to the annual headline inflation rate at end 2007/2008. (See Graph 2.)

¹ International crude oil prices reached a record high early in July 2008 with the US sweet, light crude peaking at USD\$147.27 per barrel and Brent crude oil at a high of USD\$147.02 per barrel. This followed geopolitical concerns in Iran, weak US dollar and concerns over global supplies. By end July 2008, however, oil prices were cut down following the easing of political tension between USA and Iran, fears of a global slowdown which may affect expected oil demand.



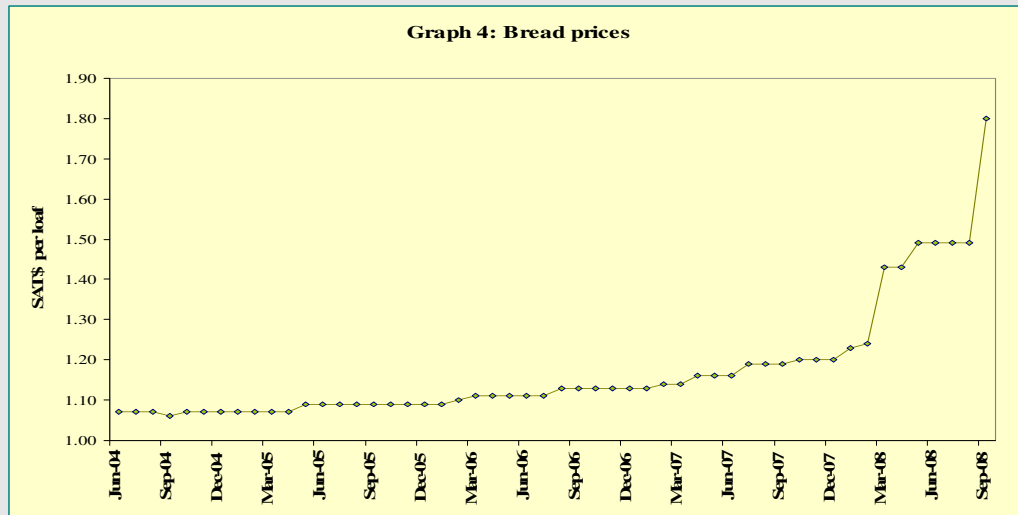
Indirectly, the higher oil prices have impacted on costs of other goods and services, which consequently affected other major sub-groups in the headline CPI. One item that was largely affected was electricity. As the diesel prices continued to rise, the Electric Power Corporation (EPC) found that it could no longer absorb the increasing cost of fuel to power its electricity generators. Consequently, in March 2007, EPC introduced a fuel surcharge on electricity consumption. In 2007/08, two additional fuel surcharges (totaling around 10.8 percent) were added onto the base tariff electricity rate compared to 15.0 percent in the previous fiscal year. In the event, electricity rates have increased an average 11 percent at end June 2008, contributing around 0.3 percentage points to the annual headline inflation rate. (See Graph 3.)



Fuel surcharges by EPC have been based on a two months lag in the trend of local fuel prices, particularly that of diesel. So far in 2008/09, two additional increases in the fuel surcharge were imposed by EPC. A 20.16 percent increase took effect on 15th August 2008 and another 2.02 percent was added on 1st September 2008. The fuel surcharge amounted to 47.94 percent, up to end September 2008².

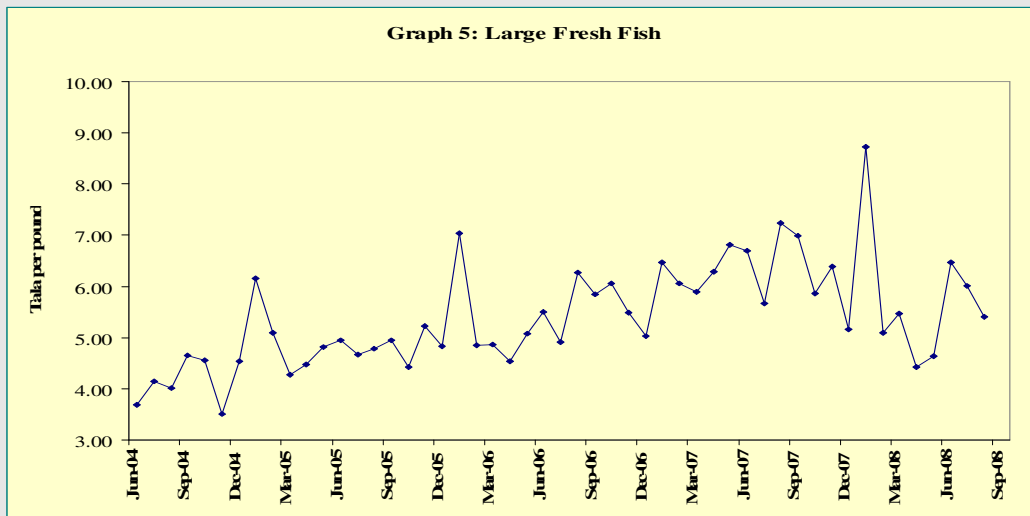
² The EPC recently reduced the fuel surcharge on the base tariff electricity rate to 39.35 percent that was effective on 1st October 2008 given the decline in international oil prices since late July 2008.

Consequent to these higher electricity costs, and a rise in the price of imported flour, the local bakery sector put through a request to the Price Control Board for an increase in bread prices. An increase of approximately 15 percent was granted in March 2008. This resulted in a 13 percent average increase in bread prices to SAT\$1.29 per loaf so far in fiscal year 2007/2008, which contributed around 0.4 percentage points directly to the annual headline inflation rate. A continued increase in diesel and flour prices led to another increase in bread prices in early September 2008, with the retail price rising to \$2.20 per loaf, a far cry from a year ago when it cost \$1.20 per loaf. (See Graph 4.)



Other food commodities that were indirectly affected by increased fuel prices were restaurant meals and locally baked cakes (through their high dependency on electricity for production). It has also been suggested by some farmers that local agricultural produce available at the Fugalei Market was also affected as rising petrol and diesel prices held back some farmers from delivering their produce to the Market.

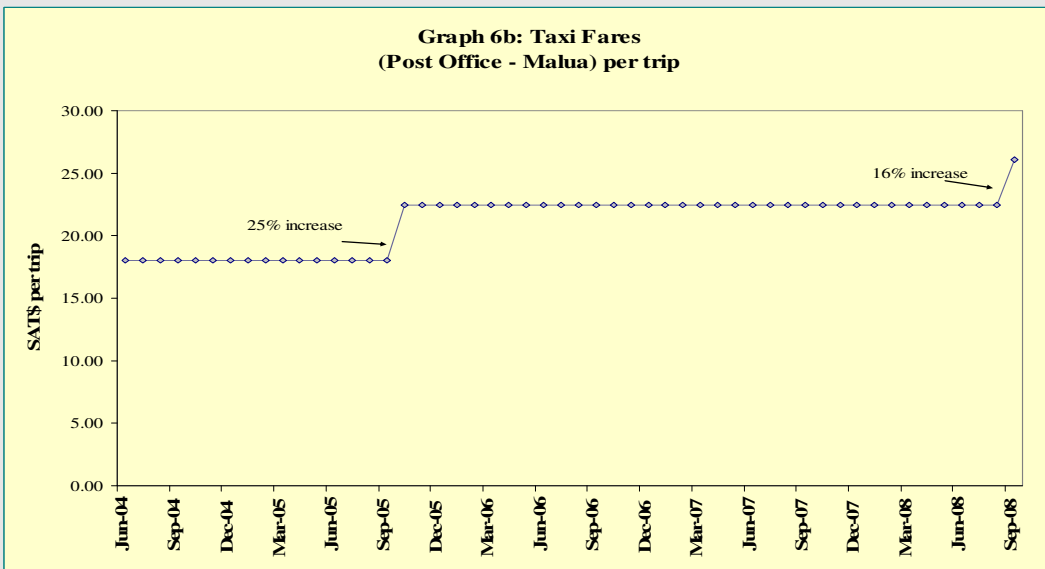
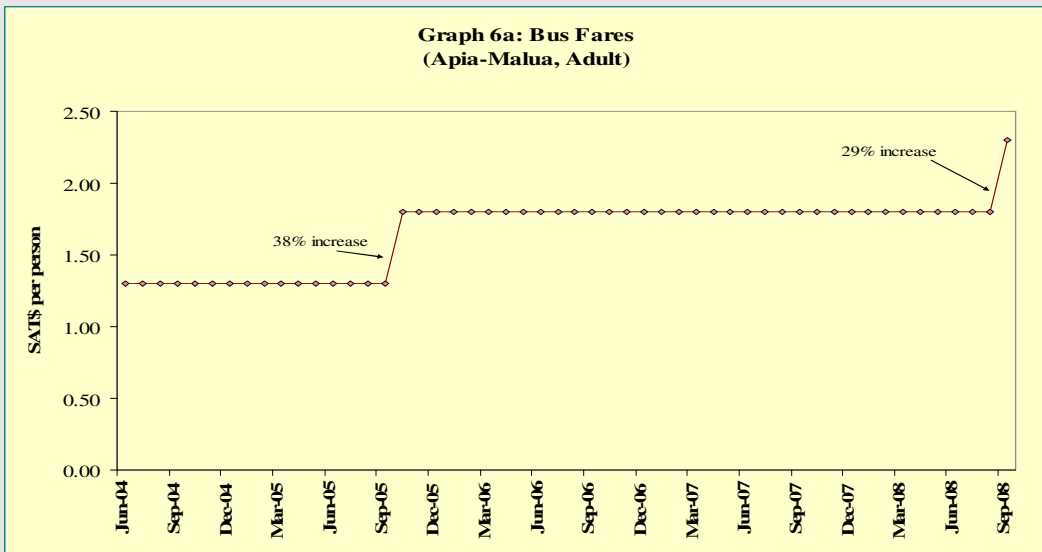
Also bearing the brunt of rising fuel prices have been the price of fresh fish sold at the Savalalo Fish Market. This indirect effect reflected the incorporation of fuel costs into the selling price of fish by sellers at the Fish Market, even though some do not require engine powered boats to fish. In 2007/08, a pound of stringed fish was sold at an average SAT\$3.60, 5 percent higher than in 2006/07. Fish pieces, on the other hand, recorded the largest increase of 10 percent, selling at an average SAT\$4.65 per pound in 2007/08, and contributing 0.1 percentage points directly to the headline inflation rate during the fiscal year. The price of large fish rose 0.4 percent in the same period to an average of SAT\$6.01 per pound. (See Graph 5.)



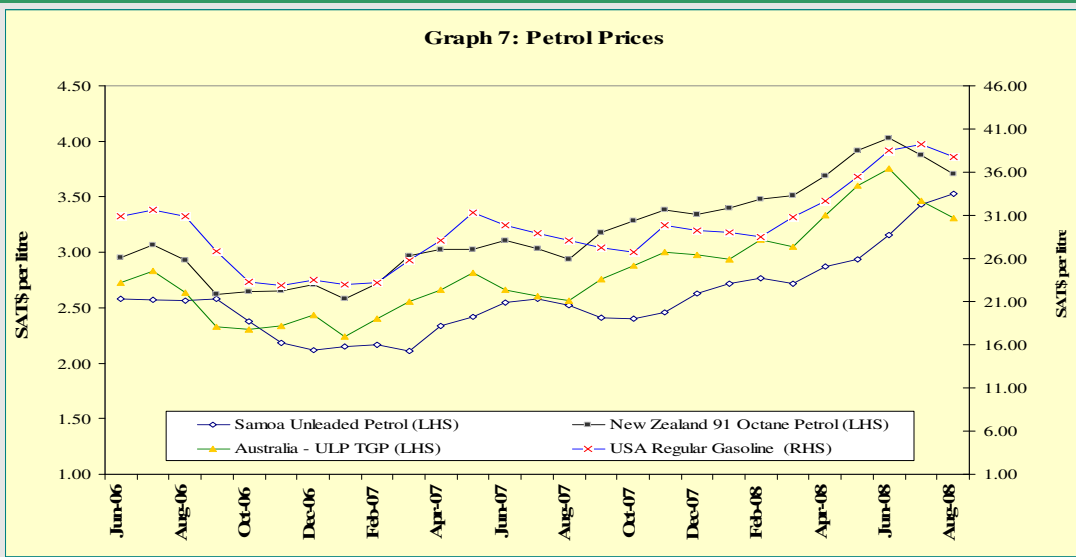
Higher fuel prices have also passed through to local transportation costs with the regulated inter-island boat fares adjusted up by 33 percent in June 2008 from the levels that were set four years ago. This saw the average level of boat fares increasing 3 percent in the fiscal year 2007/2008 and contributing 0.01 percent to higher headline inflation rate.

Those traveling overseas were also highly affected by rising fuel prices with recent CPI figures showing a 30 percent increase in international airfares reflecting higher fuel surcharges imposed on travelers. On average, international airfares have gone up 10 percent in 2007/08, adding 0.1 percentage points to headline inflation during the fiscal year.

On the ground level, taxi and bus fares were recently adjusted up on 15th September 2008 following a request by local transport operators to meet the rising cost of fuel and increased prices for other related motor vehicle products such as car batteries and car tyres. This was the first increase in fares since the last revision in October 2005. The increase averaged 16 percent for taxis and 29 percent for buses, whereas petrol prices skyrocketed from \$2.38 per litre in October 2005 to \$3.52 per litre in August 2008, an increase of 48 percent in less than three years. (See Graph 6a and 6b.)



While international oil prices have declined since peaking in early July 2008, there is little chance of it falling significantly lower in the near future and returning to their low levels of yesteryear. However, the regulation of domestic fuel prices has provided some safeguard to local consumers. The current fuel pricing formula is based on the movement of international fuel prices but with a one month lag. This method of fuel pricing has enabled Samoa to offer lower fuel prices when compared to New Zealand, Australia and USA. (See Graph 7.)



In general, although the direct inflationary pressure from the high crude oil prices is minimal, its indirect effect has been significant as the high fuel costs spilled over to prices of other goods and services in the CPI basket. The implications, therefore, of the oil price volatility in the global markets is huge for a small open economy such as Samoa.

