

II. OVERVIEW OF ECONOMIC DEVELOPMENTS DURING THE THIRD QUARTER OF 2009.

a. The World Economy

In the September quarter of 2009, economic growth rates for the United States, Japan, the Euro area, Australia and New Zealand continued to trend upwards. Although the pace of growth between quarters was positive, with the exception of the United Kingdom which posted another contraction in the quarter under review, the annualized growth rates remained negative for most of the above mentioned countries. Some weaknesses in the various sectors of these economies were still observed, particularly in the housing sector, the retail trade industry and, for some economies, the industrial and manufacturing sectors. Surprisingly, for all of the countries mentioned, consumer and business sentiment improved over the quarter under review. Nevertheless, a fragile recovery was the general diagnosis for most economies and, as a result, the reserve banks resumed their expansionary monetary policy stances. Price pressures, on the contrary, were receding quite nicely and, as such, have become the least of the reserve banks' concerns.

In the United States, the third preliminary real growth estimates showed that the economy expanded at an annual rate of 2.2 percent in the September quarter, following a 1.0 percent contraction in the previous quarter. Economic statistics indicated positive contributions to growth from personal consumption, exports, private inventory investment as well as an increase in federal government spending. Residential fixed investment also contributed to the positive growth rate. However, positive contributions to growth were offset by negative contributions from non-residential fixed investment, increased imports, declining state and local government spending as well as the deceleration in federal government spending. While economic conditions appear to have picked up in the various sectors of the US economy, a hint of weakness remains in the overall state of the economy as the retail sales industry continues to post negative movements, industrial production continues to grow at meagre rates, while housing data continue to show a decline in home sales. The labor market remained weak as personal income grew at rates less than half a percent over the quarter under review while the unemployment rate rose to 9.8 percent in the third quarter from 9.5 percent in the June quarter of 2009. Despite signs of a frail recovery in the US, consumer confidence is starting to improve considering that the economy is gradually lifting itself out of a deep downturn. Consumer prices rose 0.1 percent in the third quarter but on an annual basis, prices fell 1.3 percent.

Over the September quarter, the Federal Reserve Bank of New York continued its expansionary monetary policy stance given the frailty of the US recovery. As such, the Fed maintained the Federal funds rate at its targeted level of zero to 0.25 percent.

In the September quarter, the Australian economy continued to fare better than most other major economies and again turned out a positive growth rate. The Australian economy grew 0.5 percent in the third quarter from the previous quarter, taking the annual rate to 1.0 percent and compares with 0.3 percent growth in the previous quarter. The housing market started to pick up in the third quarter as house prices began to post solid gains, housing finance increased and building approvals rose. Retail trade data also continued to produce positive growth rates in the third quarter with overall growth rate of 1.4 percent. Sentiments among businesses and consumers were also looking up as the third quarter progressed. In the labor market, the unemployment rate stood still at 5.8 percent. Prices in the Australian economy continued on their downward trend as inflation slowed to 1.0 percent over the quarter, taking the annual rise in prices to 1.3 percent, which was down from 1.5 percent in the June quarter.

In the third quarter, the Reserve Bank of Australia (RBA) continued to stress its intention to maintain an easing monetary policy bias to ride out the recession and, as such, held its official

interest rate unchanged at 3.0 percent while it continued to observe developments in the economy facilitated by fiscal and monetary stimulus.

In the New Zealand economy, the annual growth rate was again negative at 1.3 percent. However, compared to the previous quarter, the rate of decline was slower. Between the second and third quarter, the economy grew by 0.2 percent. Retail sales improved slightly from the previous quarter as it showed gains of around 0.5 percent in the September quarter. The housing market again showed signs of weakness as building permits turned out negative percentage changes of more than 10 percent while house sales actually posted positive increases of over 1.0 percent in the quarter under review. Nevertheless, consumers were increasingly confident about the economy's recovery as the confidence index steadily rose over the quarter from 96 to 120.3. Unemployment in New Zealand continued to increase as the jobless rate rose from 6.0 percent in the June quarter to 6.5 percent in the quarter under review. Consumer price pressures abated with the CPI declining 1.3 percent from the previous quarter. On an annual basis, inflation was 1.7 percent in the September quarter, down from 1.9 percent in the previous quarter.

In the September quarter, the Reserve Bank of New Zealand (RBNZ) also upheld its easing monetary policy stance as it kept focus on the risks of a deeper downturn and paid less regard to inflationary pressures, which were already well within target levels. As such, the overnight cash rate was maintained at 2.5 percent.

In the quarter under review, the Euro area grew 0.4 percent from the previous quarter but on an annual basis, the Euro area contracted 4.0 percent, which is a slower contraction than in the June quarter of 4.8 percent. Total industrial production in the Euro region continued to decline in the September quarter, while industrial new orders reported small increases over the same period. The slump in retail sales slowed between months but on an annual basis, data continued to reflect the significant weakness in the retail activity. Despite signs the Euro area recovery remains fragile, confidence among consumers gradually improved over the third quarter and likewise, the overall economic sentiment has improved in the quarter under review. In the labour market, the unemployment rate increased to 9.6 percent from 9.3 percent in the June quarter of 2009. Consumer prices in the Euro area fell 0.4 percent in the September quarter, slowing the annual rate of inflation to 0.3 percent.

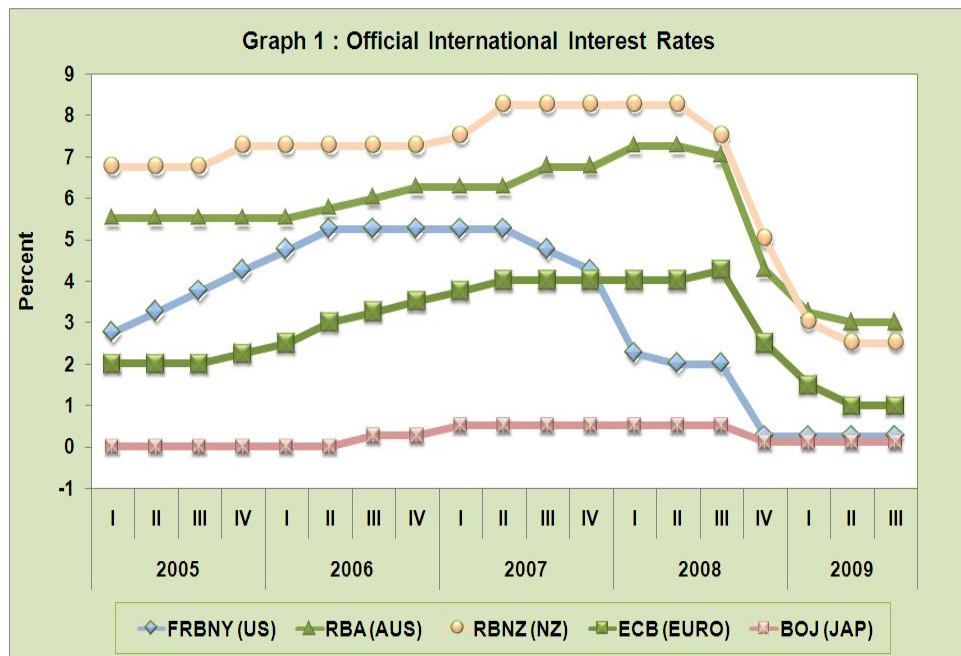
In the September quarter, the European Central Bank (ECB) kept its official interest rate unchanged at 1.0 percent given the frail economic conditions.

In the United Kingdom (UK), gross domestic product contracted by 0.2 percent in the September quarter, after declining 0.8 percent in the previous quarter. Production and service industries posted positive gains over the quarter after declining in the previous quarter, while the housing market showed a turnaround, with construction output increasing in the same period after previously recording a decline. Average earnings continued to increase in annual terms despite marginal monthly declines. Still, improved confidence data signal more upbeat consumers. As such consumer expenditure has increased over the quarter. Government consumption expenditure also rose over the third quarter. Retail sales activity continued to improve as total sales increased 1.8 percent in annual terms and continued the uptrend from the June quarter gains. The labour market remained moderately weak with the unemployment rate still at 7.8 percent. The annual inflation rate in the UK eased to 1.1 percent in the quarter under review, down from 1.8 percent in the preceding quarter.

The Bank of England (BOE) kept its official interest rate on hold at 0.5 percent as it continued with its 'easing' monetary policy stance to counter the continued weak economic activity in the UK.

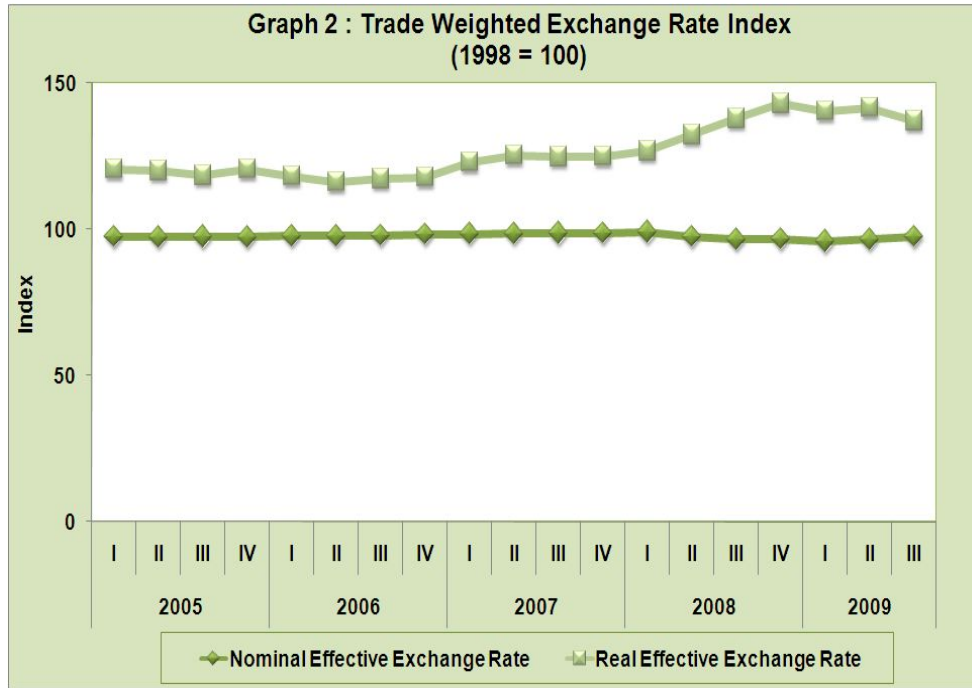
National accounts figures for Japan showed that real gross domestic product grew 2.9 percent in the September quarter from the previous quarter, taking the annual contraction to 4.5 percent, a slowdown from the revised 7.0 percent slump recorded in the second quarter. After subdued June quarter retail sales activity, retail sales posted modest gains in the September quarter. Housing market activity also stabilized as housing starts posted increases of around 0.7 million during the three months of the third quarter. Machinery orders and indices gauging industrial production activity also picked up in the quarter under review. Consistently, Tankan confidence indices showed an improvement in sentiment among large manufacturing and non-manufacturing companies regarding business conditions in Japan. Japan’s labour market picked up over the quarter as the unemployment rate gradually fell from 5.7 percent in July to 5.3 percent in September. Consumer prices continued to decline at an annual rate of 2.2 percent, which is higher than in the previous quarter’s inflation rate of negative 1.7 percent.

In the September quarter, the Bank of Japan continued to hold its official interest rate unchanged at 0.1 percent. (See Graph 1.)



In the currency markets, the US dollar continued on its downward trend as signs of a receding downturn in the global economy helped sustain the global equity market rally. The increased appetite for risk and simultaneously reduced appetite for the safe haven dollar, which accompanied the rallying commodities and equity markets helped support ongoing strength in the currencies of the Euro, the UK, Australia, New Zealand and Japan.

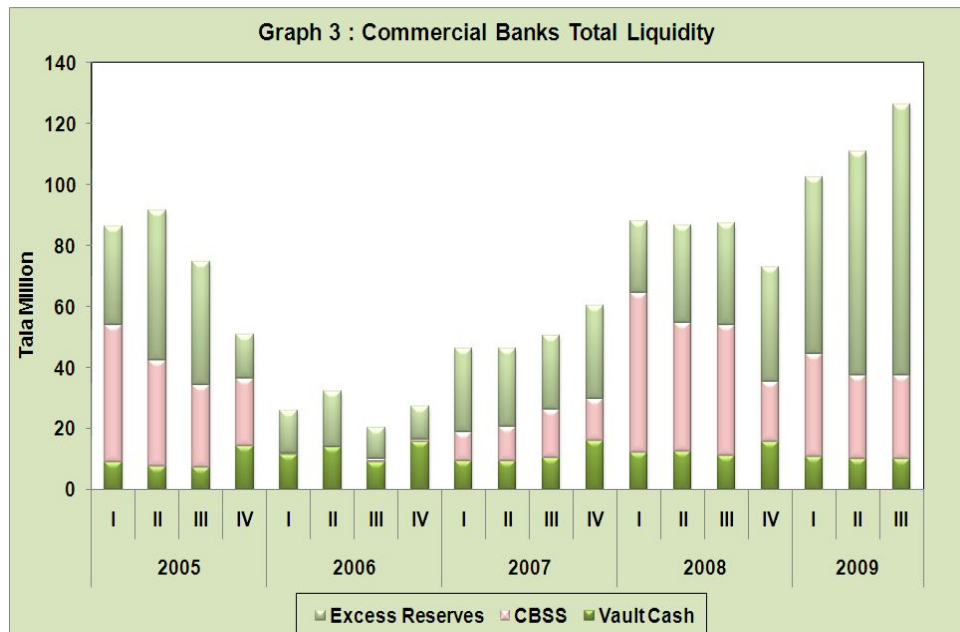
In terms of the Tala’s nominal index, the overall value of the Samoan currency against the currency basket depreciated 1.3 percent on an annual basis in the September quarter. In real terms, the real effective exchange rate indicated that the Tala appreciated by 7.9 percent. The increase in the real effective exchange rate, despite the nominal depreciation of the Tala, indicated that prices in Samoa continued to rise faster and remained persistently higher than those of its major trading partners. (See Graph 2.)



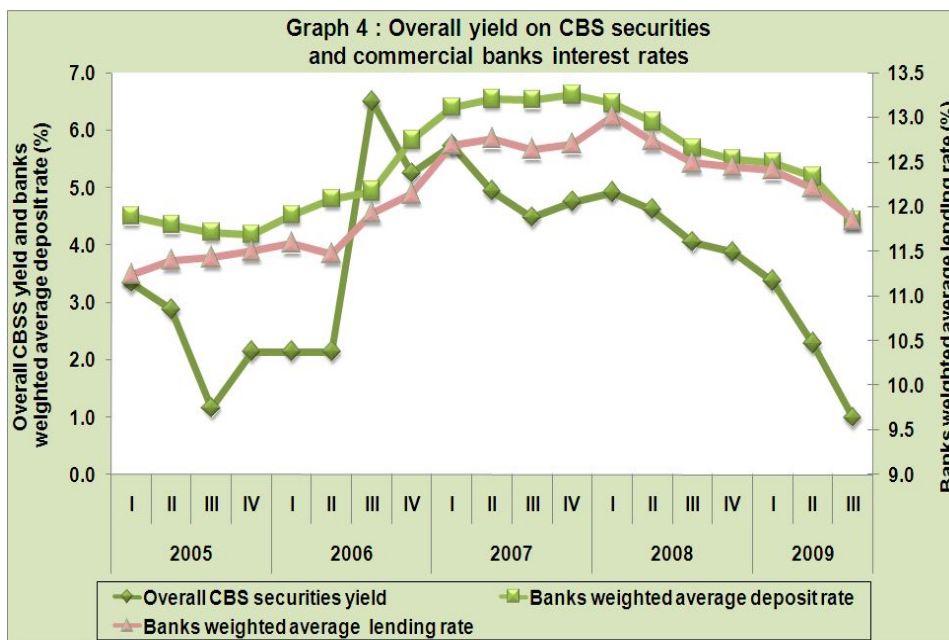
b. The Domestic Economy

Fiscal policy tightened in the September 2009 quarter with Government’s financial operations recording a cash deficit of \$29.4 million to \$110.5 million.

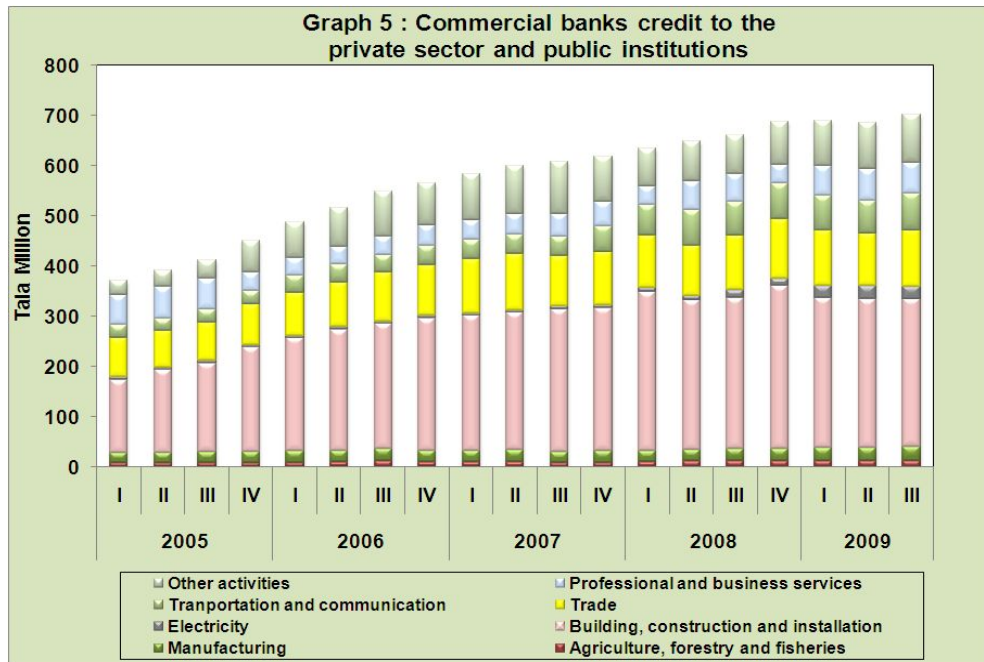
Monetary policy, on the other hand, continued its’ easing stance in the quarter under review, with total commercial bank liquidity growing a further 14 percent to \$126.3 million on the back of an \$8.3 million (or 8 percent) increase in the June 2009 quarter. The commercial banks’ excess reserves in particular, rose by a further 21 percent to \$88.8 million while their holdings of CBS securities were maintained at \$27.4 million. Cash holdings of commercial banks, on the other hand, declined \$0.2 million during the quarter under review. (See Graph 3.)



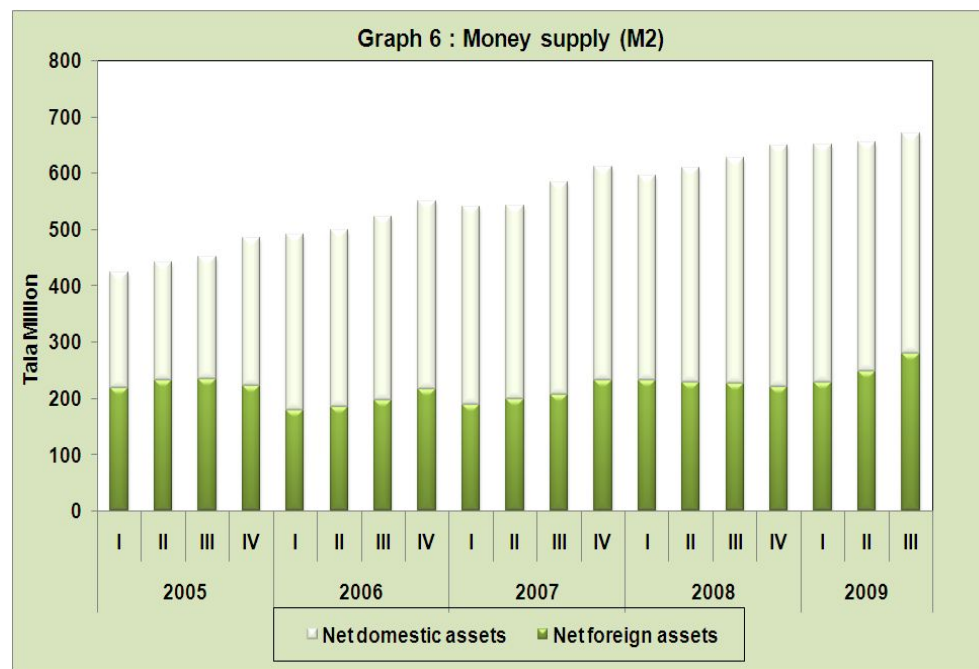
In line with the easing monetary policy stance, official interest rates on Central Bank Securities fell to a weighted average yield of 0.99 percent in the September 2009 quarter, from 2.28 percent in the preceding quarter and 4.05 percent in the September quarter of 2008. This large drop reflected lower yields for all CBS papers especially the 91-day and 182-day papers. Corresponding to the decline in official rates, the commercial banks' interest rates fell, with the weighted average deposit and lending rates easing by 77 basis points to 4.42 percent and 36 basis points to 11.85 percent respectively. In the event, the commercial banks' interest rate spread widened to 7.43 percent from 7.02 percent in the previous quarter. (See Graph 4.)



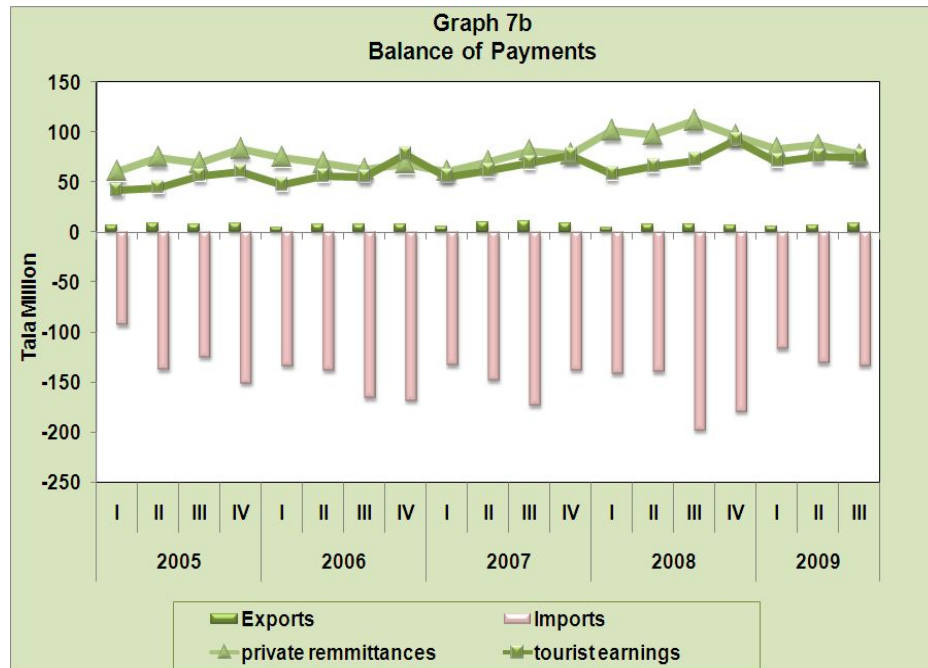
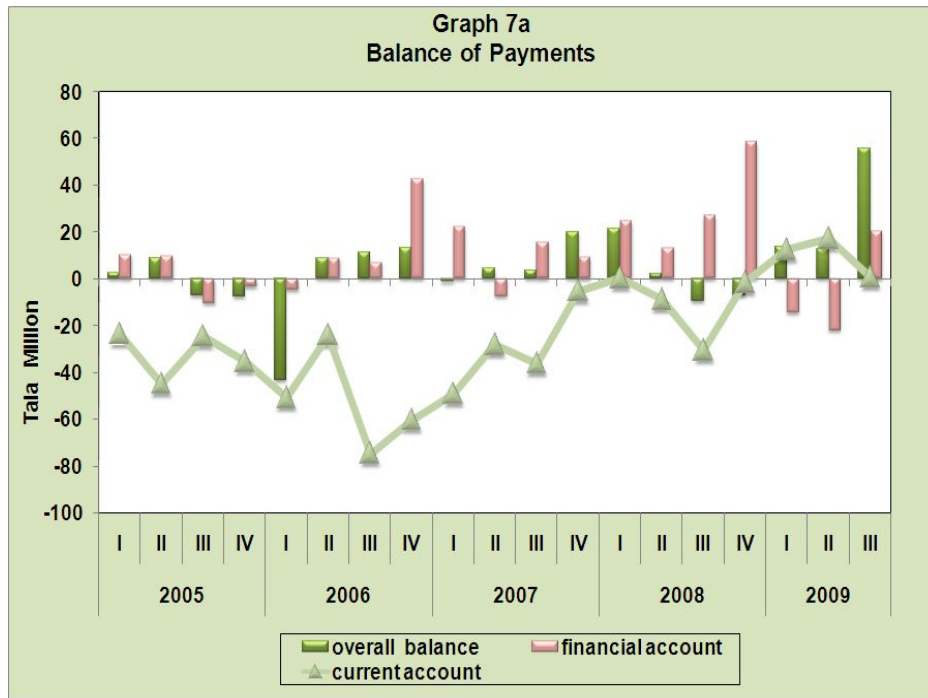
With lower lending rates, commercial bank credit to the private sector and Government corporations grew further by 2 percent (\$15.8 million) to \$701.2 million compared to a drop of \$5.1 million in the June 2009 quarter. The bulk of bank lending during the September quarter was absorbed mainly by the “Trade” (up \$7.8 million to \$293.8 million), “Other activities” (up \$4.5 million to \$96.4 million), “Transport and communication” (up \$4.3 million to \$73.3 million), “Electricity and gas” (up \$3.4 million to \$26.1 million) and “Manufacturing” (up \$0.9 million to \$27.1 million) sectors. On the other hand, lower credit was extended to the “Professional and business services” (down \$1.9 million to \$60.2 million), “Building and construction” (down \$1.7 million to \$293.8 million) and “Agriculture” (down \$0.03 million to \$12.6 million) sectors. (See Graph 5.) On an annual average basis, however, the rate of growth of commercial bank loans outstanding continued to slow down to 8.3 percent at end September 2009, from 9.1 percent at end June 2009.



As a result of a 13 percent (\$30.4 million) hike in net foreign assets, which more than offset a 3 percent (\$14.3 million) drop in net domestic assets at end September 2009, total money supply (M2) expanded 3 percent (\$16.1 million) to \$670.4 million. (See Graph 6.)



After recording an \$8.4 million surplus in the previous quarter, the balance of payments registered a record quarterly surplus of \$54.9 million in the September 2009 quarter. This position was mainly due to a \$34 million allocation of SDRs from the IMF in August 2009, as well as a strong inflow in the financial account. (See Graph 7a.) The drop in the current account surplus reflected a drop in private remittances, increase in income payments, slightly higher import payments and lower tourism proceeds during the September quarter of 2009. (See Graph 7b.)



The merchandise trade balance deteriorated slightly by 1 percent (\$1.2 million) to \$125.3 million, as a 2 percent (\$2.8 million) increase in imports more than outweighed a 22 percent (\$1.6 million) rise in exports.

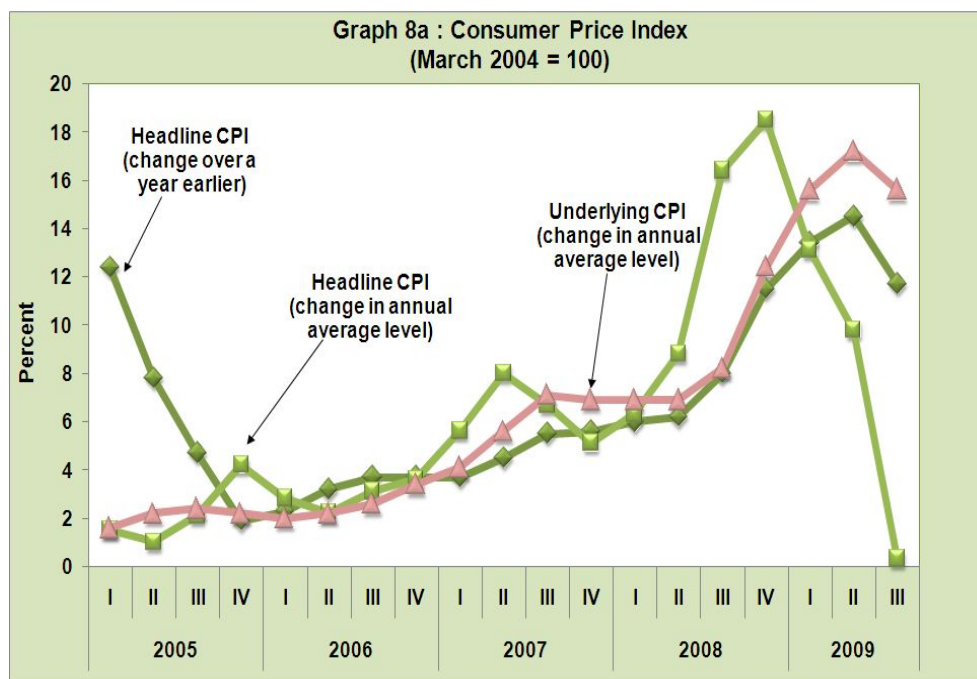
Underpinning the increase in import payments in the September 2009 quarter was a 22 percent hike in petroleum imports (\$5.1 million) which coincided with a the rebound in petroleum prices globally as well as a 5 percent (\$4.4 million) rise in the private sector imports reflecting one-off items such as a new fishing vessel for a local fishing company.

The main contributor to the higher level of exports in the third quarter of 2009 was a \$1.6 million increase in domestic exports despite a \$71 thousand drop in re-exports. The hike in domestic exports was mainly attributed to fresh fish (up \$1.1 million) and coconut oil (up \$0.89 million) as

well as smaller gains from exports of beer (up \$87 thousand), coconut cream (up \$81 thousand) and virgin oil (up \$65 thousand). These increases more than offset decreases in earnings from nonu juice, (down \$0.4 million), taro (down \$36 thousand) and soft drinks (down \$61) and coconuts (down \$43 thousand).

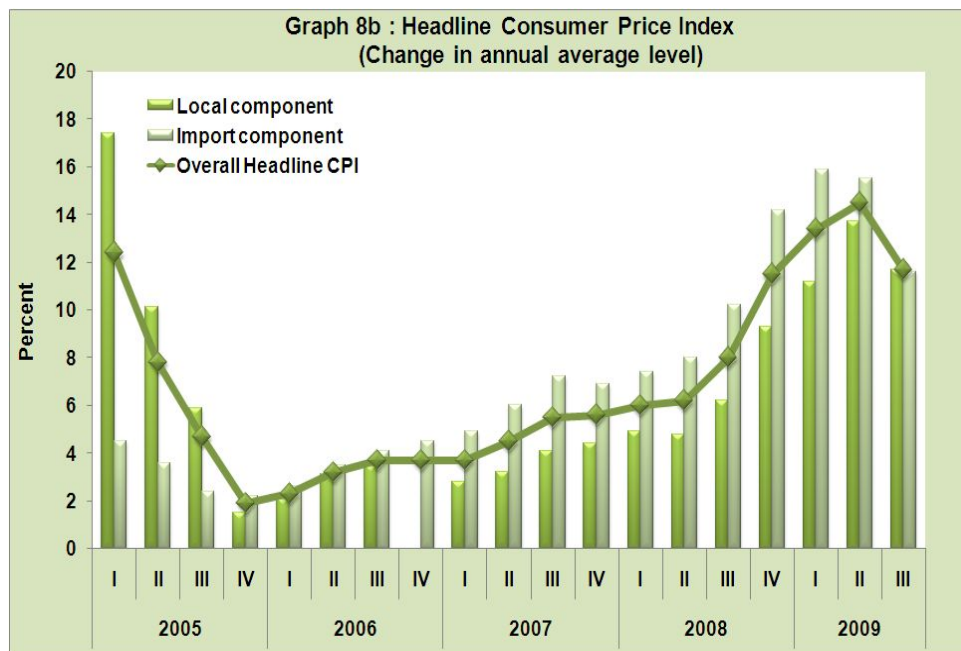
Following a 7 percent jump in the June 2009 quarter, foreign exchange revenue from tourism fell 1 percent (\$0.6 million) reflecting a seasonal 11 percent drop in average tourist expenditures despite an increase of 10 percent in tourist arrivals. Of the lower arrivals in the three months to September 2009, the majority were, as usual, those from New Zealand (44 percent) with American Samoa and Australia recording shares of 18 percent each. The majority (43 percent) of travelers were tourists who were here on holiday mainly for the Teuila Festival in September, while 36 percent were those who came to “visit friends and relatives”. The inflow of private transfers fell by 11 percent (\$9.7 million) in the September 2009 quarter, reflecting a 56 percent (\$6.5 million) drop in remittances for charitable organizations and a 4 percent (\$2.9 million) fall in household and family remittances.

On prices, both the external (particularly easing international food prices) and domestic factors (lower prices for agricultural commodities) dominated price developments in the September 2009 quarter. The average level of the headline CPI, which was 3.3 percent higher than in the same quarter a year earlier, registered a 1.6 percent deflation in the quarter under review reflecting decreases of 2.4 percent and 0.6 percent in its local and import components respectively when compared to the June 2009 quarter. Consequently, the headline inflation rate, on an annual average basis, fell to 11.7 percent at end September 2009, from 14.5 percent at end June 2009. It was, however, higher compared to 8.0 percent at end September 2008. Similarly, the annual average underlying inflation rate decelerated to 15.6 percent from the 17.2 percent at end June 2009, but was higher than the 8.2 percent rate a year earlier. (See Graph 8a.)



The price reductions during the quarter under review were driven by improved local production of agricultural commodities, the slowdown in world demand as a result of the global recession as well as improved global supplies. Local food prices at the Market fell sharply reflecting a large rebound in the local supply of vegetables (such as head cabbage, Chinese cabbage, water cress, tomatoes, cucumber and pumpkin) and staple food crops (particularly taamu and breadfruit). The lower imported food prices (mainly for rice and eggs) in the September 2009 quarter reflected

factors such as the weak US dollar and lower inflation rates for Samoa’s major trading partners (particularly New Zealand and Australia) in the quarter under review. These bearish factors were underpinned by the combined favorable trends of economic fundamentals in the international commodity markets primarily increased production levels (for grains such as rice and wheat) as well as reduced world demand, consequent to the global economic recession. Reduced prices for energy services in the form of kerosene, natural gas and electricity also contributed to the lower headline CPI in the September 2009 quarter with the latter reflecting the local pricing mechanism where the fuel surcharge on the base electricity tariff rate was reduced 34 percent to 5.41 percent at end September 2009 from 8.21 percent at end June 2009. Similarly, a decline in the price of locally produced Vailima beer in August 2009 also contributed to the general drop in the headline CPI in the quarter under review. These developments saw a decrease in the “Food” sub index (down 2.1 percent) due to reductions of 5.7 percent and 0.7 percent in its local and import components respectively. The “Housing and Household Operations” sub-group fell by 0.7 percent while that of “Alcohol and Tobacco” was down by 0.8 percent in the September 2009 quarter. These decreases were partially outweighed by increases in “Transport and Communication” (up 0.2 percent), “Clothing and Footwear” (up 0.2 percent) and “Miscellaneous” (up 0.9 percent), and sub-groups during the quarter. (See Graph 8b.)



III. PRUDENTIAL SUPERVISION

For the quarter ended 31 December 2009, the banking system registered another moderate growth in total assets despite a strong liquidity level being maintained over previous quarters. The commercial banks have maintained strong capital adequacy level with ratios comfortably above the Central Bank's minimum requirement of 15.0 percent.

Nevertheless, the noticeable strong rise in non-performing loans would, to some degree, discount such positive performance, thus requiring banks to be more vigilant in managing the various risks that they underwrite.

For the first time, the banking system combined assets reached the \$1.0 billion mark since establishment, reflecting an increase of 5.8 percent (\$56.3 million) in the December quarter. On an annual basis total assets grew by 10.7 percent (\$98.2 million) over a year earlier.

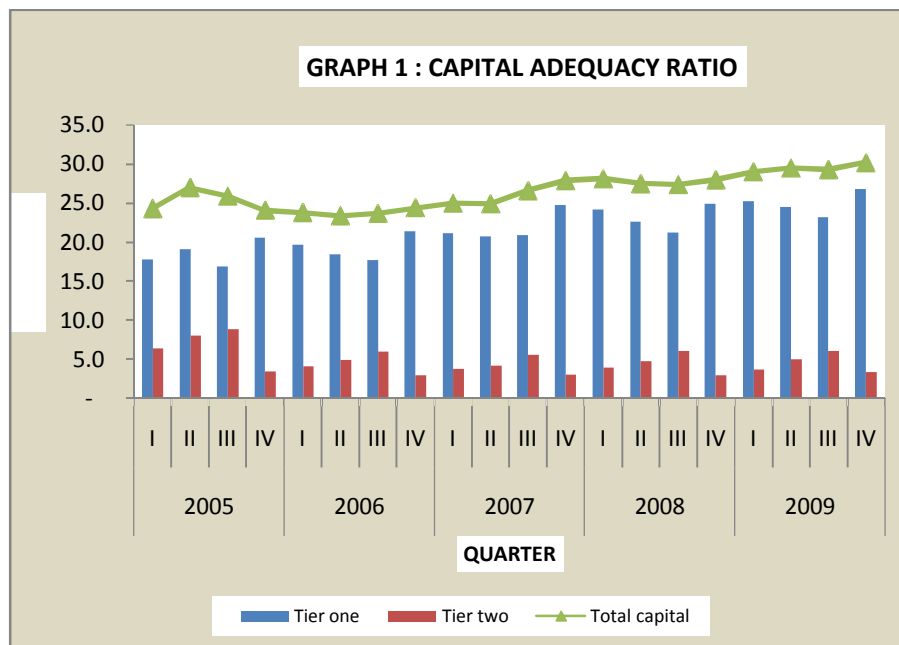
The composition of the commercial banks assets comprised mainly of loans and advances of \$734.5 million (72.1 percent of total assets), cash reserves and deposits with the Central Bank and other banks combined at \$245.0 million (24.1 percent) and fixed assets of \$60.5 million (5.9 percent) respectively.

Total loans and advances of \$734.5 million increased minimally by 0.5 percent (\$3.3 million) at the end of the quarter and reflected an increase of 2.8 percent (\$19.7 million) over the same time a year earlier. Loans to businesses and private households dominated the growth in loans and advances for the quarter.

Total deposit liabilities rose by 7.1 percent (\$50.8 million) to \$711.3 million in the quarter and recorded an annual growth of 9.6 percent (\$66.9 million) respectively. Time deposits (\$429.2 million) represented 56.3 percent of total deposits, demand deposits (\$247.5 million) accounted for 32.5 percent while savings deposits (\$85.4 million) made up 11.2 percent of total deposit liabilities.

Total contingent and off-balance sheet items increased by 14.8 percent (\$15.6 million) to \$121.1 million over the previous quarter, due mainly to the increase in unmatured foreign exchange contracts.

The banking system remained strongly capitalized at \$189.2 million, revealing an increase of 2.9 percent (\$5.3 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 edged up by 0.9 percent to 30.2 percent. Tier 1 capital of 26.8 percent increased by 3.6 percent over the September 2009 quarter. (See Graph 1.)



The level of liquid assets increased by 19.8 percent (\$24.9 million) to \$151.1 million over the previous quarter. The increase in deposit liabilities, mainly demand and saving deposits, were the main sources of liquid funds received by the banking system during the quarter. On an annual basis, the banking system's overall liquidity level improved by 106.8 percent (\$78.0 million) when compared to the same time a year earlier. At this level, it represents 22.0 percent of total domestic deposit liabilities.

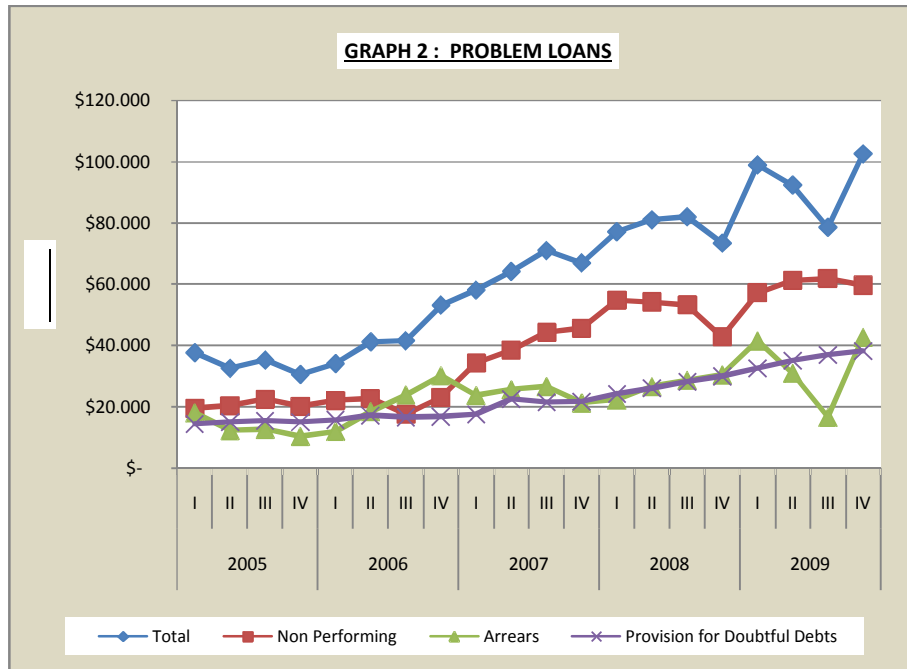
To date, total Central Bank Securities stood at \$27.5 million, increased by 0.2 percent (\$0.06 million) at the end of the quarter.

The combined foreign assets of the commercial banks amounted to \$123.8 million as compared to total foreign liabilities of \$117.2 million. At these levels, it showed a net long exposure position of around \$7.6 million or 4.0 percent of total capital of the banking system.

At the end of the quarter, the overall level of non-performing loans reduced by 3.6 percent (\$2.2 million) to \$59.7 million. As compared to the prior year, it registered an increase of 39.1 percent (\$16.8 million) respectively. In relation thereto, total provision for bad and doubtful debts of \$38.2 million provides a 64.0 percent buffer against possible loan losses as a result of non-performing loans. In proportion to total loans and advances, total provision stood at 5.2 percent respectively.

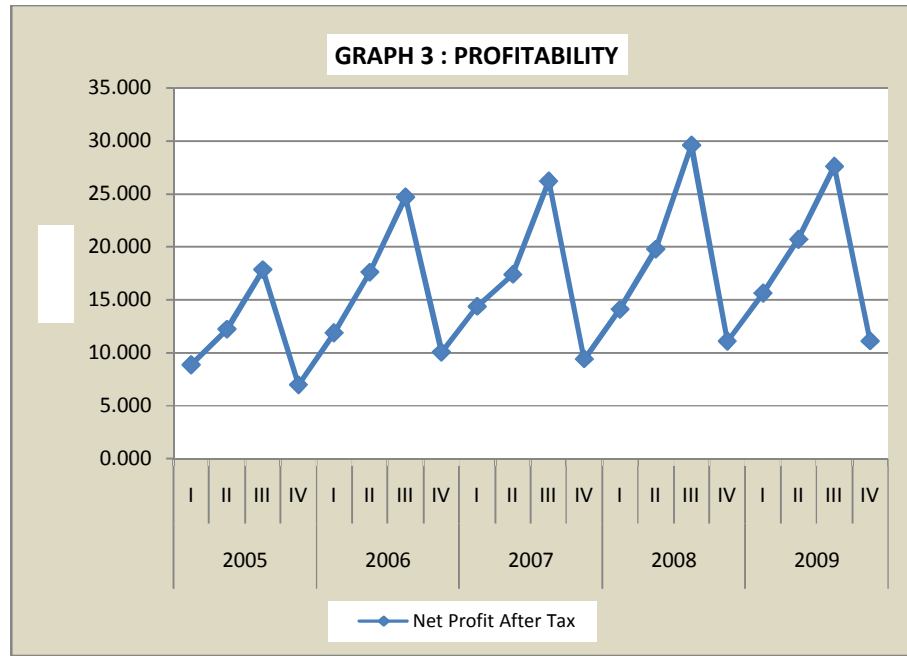
The Central Bank continues to monitor closely the banks performances towards reducing their levels of arrearages and non-performing loans.

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 2).



At a combined figure of 15.2 million, the banking system’s pre tax profit level increased slightly by 0.1 percent when compared to the same period a year earlier. Total net profit after tax amounted to \$11.1 million, minimally increased from a year earlier.

At this level, return on average network and assets stood at 6.3 percent and 1.1 percent respectively. (See Graph 3).



For the period under review, total operating expenses represented 71.0 percent of total income, more or less the same level achieved in the previous year. Furthermore, the banks recorded a good earnings from their foreign exchange profits.

IV. GOVERNOR'S SPEECH AT THE USP DIALOGUE ON 14th DECEMBER 2009**PRESENT CHALLENGES FACING THE SAMOAN ECONOMY**
AN OVERVIEW

Ladies and Gentlemen.

At the outset, I would like to take this opportunity to thank the Organisers for inviting me to speak at this important Dialogue.

This Dialogue, and especially the topics to be discussed, is indeed timely, more so at this time when the resilience of the Samoan economy is being tested, not only by the effects of the global financial crisis but more recently by the September 29 tsunami. It is, therefore, a pleasure for me to be here this morning to present you an **Overview of the Present Challenges facing the Samoan Economy**.

But, before I do that, I think it would be useful to provide a brief overview of the performance of the Samoan economy in recent years as well as in the first four months of the current fiscal year 2009/10.

A. Samoa's Economic Performance to Date

Prior to the onslaught of the global recession in 2008/09, Samoa's economy has been performing relatively well, with real GDP growth averaging 4.5 percent per annum in the five years to end June 2008. The main drivers of economic growth have been largely 'Construction', assisted by 'Transport & Communications', 'Commerce', 'Hotels & Restaurants' and the 'Finance & Business Services' sectors. The construction sector has benefitted mainly from large public infrastructural projects like the 13th South Pacific Games facilities, new school buildings, upgrading of roads, new seawalls as well as private sector developments in hotels, office buildings and the many new churches. The entry of Digicel, together with further diversification of Samotel's services, have contributed to the expansion of the 'Communications' sector while the transport industry has benefitted from the growth in construction activities. The 'Hotel & Restaurants' industry has seen steady growth with the addition of new hotels, both luxury and budget type accommodations, as well as increased competition among the airline carriers serving Samoa.

Unfortunately in 2008/09, the impact of the global financial crisis on world demand reached Samoa's economy. The production and export of automotive wire harnesses to Australia, by Yazaki Samoa in 2008 and early 2009, declined dramatically. The unfortunate consequence was that Yazaki had to reduce both its workforce and its working hours to cut costs. The winding down of economic activities, following the South Pacific Games in September 2007, combined with the adverse impact of the global recession on the local economy to drive down real GDP by about 6 percent in 2008/09.

In the current fiscal year (2009/2010), whilst we were busy trying to plan and steer the economy out of recession, we were hit by the 29 September earthquake and tsunami.

Prior to the tsunami, the tourism industry performed remarkably well while private remittances were slowly declining, consequence of the global recession. The economic indicators for the four months to end October 2009 are somewhat mixed. Tourism earnings were up, when compared to the same period last year. Similarly with export revenues, which were also higher. On the other hand, private remittances were down. Imports dropped dramatically, largely due to weak domestic demand, while agriculture production improved with the supply of agricultural produce at the Fugalei Market rising 18 percent. This helped to lower the prices of local food items, resulting in a

continuing decline of our inflation rate to 9.9 percent in October from its peak of 14.5 percent in June this year. Our foreign exchange reserves have continued to remain at a healthy level, registering close to 7.5 months import cover in October.

B. Present Challenges facing the Samoan Economy

Let me now turn to some of the key Challenges being faced by the Samoan Economy in the current period.

Indeed, there are many challenges facing our economy. But the most immediate ones arise from the current global recession and the tsunami, while others are more towards the medium to long term time frame.

The immediate challenges facing us at the moment include:

1. Firstly, Tsunami Reconstruction and Rehabilitation

Reconstruction and recovery works, in the aftermath of the tsunami, are expected to cost the Government about \$272 million. Funding such a huge bill is a major challenge, especially at this time when the economy is in recession. Reprioritising Government spending or finding additional tax revenues to fund the tsunami bill will be very difficult indeed, especially under the present circumstances. And, given that it has an enormous foreign exchange element, it is crucial that much of this funding come from abroad, preferably in the form of grants and concessional loans. Otherwise, our international reserves will come under enormous pressure. The challenge for the Government, therefore, is to seek additional concessional funding from overseas for tsunami relief work, over and above the large foreign financing already earmarked for the stimulus budget deficit for the current financial year.

2. The second Challenge relates to Reviving Business Confidence

The global recession and the tsunami have combined well to zap the confidence of the business community. The end result is reduced demand for credit with the business community reluctant to invest, especially at the prevailing high interest rates. But, if the economy is to recover quickly, business confidence needs to be revived. One of the key variables to reviving business confidence is the cost of funds. Through moral suasion, the Central Bank has managed to convince the commercial banks to bring their interest rates down. But, the timing has been slow with the magnitude of the reductions not sufficient enough to entice the private sector to invest. In the event, the Central Bank is having regular discussions with the banks to try and bring their interests rates down further and sooner.

3. Thirdly, Reviving Agricultural Production

Agriculture production has been on a declining trend for some time now. The end results have been sharp rises in local food prices and increasing demand for imported food items. To safeguard against imported inflation and to provide for our own food security, we need to revive agriculture production. We need to diversify into more resilient agricultural products and improve on our farming techniques. High costs of production and unavailability of planting materials to prospective farmers have been common concerns.

4. Reviving the Export Sector

Samoa's export performance has been deteriorating over the years due to a combination of factors, such as supply shocks (owing to volatile weather conditions, pests and diseases) and demand side issues, such as fickle international demand and stringent quality control requirements of overseas markets. Lower international prices and strong competition from cheaper Asian substitute products have also contributed to the decline in export earnings over the recent years. Unfortunately, our exports have been based on a very narrow range of products and is dominated by agriculture based products and fish. The global recession and the

closure of one of the fish canneries in American Samoa highlight the critical importance of diversifying our product range and markets.

The tight quarantine and health restrictions in overseas markets also point to the need to develop more processed manufactured exports. This challenge is currently being addressed by the Government with the launch early this year of the National Export Strategy. An important element of this Strategy involves the establishment of a National Export Agency to coordinate and manage the export sector.

5. Making Monetary Policy more Effective

The onset of the recession in 2008/09 pointed to the need to inject more liquidity to stimulate the ailing economy. Consequently, in fiscal year 2008/09 and the current financial year, the Central Bank adopted an expansionary monetary policy stance. The immediate objective was to drive down market interest rates by reducing the official interest rates. However, whilst the Central Bank succeeded in sharply reducing the official interest rates, the market lending rates fell slowly and marginally.

One of the main contributing factors to the slow decline in market interest rates was the dominant position held by the Samoa National Provident Fund (SNPF) and the Accident Compensation Corporation (ACC) in the wholesale deposit market. SNPF and ACC deposits are considered by the commercial banks as “hot money”, being very large and regular sources of deposits. Competition amongst the banks for these funds was so fierce that they attracted very high deposit interest rates. The end result was that the lending rates also needed to remain high to match the high deposit rates. Consequently, the demand for credit continued to weaken.

To avoid returning to direct controls to bring down interest rates, the Central Bank decided to explore the possibility of pumping liquidity into the economy via selected non bank financial institutions such as the Development of Samoa (DBS) and the Samoa Housing Corporation (SHC). Credit lines to these institutions will be provided at the same low interest rates offered to the commercial banks. This strategy will be implemented soon but priority has now been given to the reconstruction of tourism facilities that were affected by the tsunami. To this end, the Central Bank’s Board of Directors has approved a credit line of \$5.0 million to be made available this week to the DBS on concessional terms.

In the longer term, the Central Bank is looking at reviewing its 1984 Principal Act to, among other things, allow CBS lending to other non-bank financial institutions for specific purposes.

6. Declining Private Remittances – Filling the Gap

The global recession is taking a toll on the inflow of private remittances. The downward trend was, fortunately, significantly reversed by the tsunami in October 2009 as overseas communities dug deeper to send home money, food, clothing, construction materials and other supplies to assist the affected villages. However, what is likely to happen is that private remittances in the future months will fall drastically as the overseas communities succumb to the continuing adverse effects of the global recession on employment. And, with many families having received substantial amounts in the months following the tsunami, the challenge then would be to find ways to fill the gap. This is why the revival of the agriculture sector is vitally important, to provide alternative sources of income for the people affected.

Those are some of the immediate challenges that we are currently facing. For the medium to long term, the key challenges include the following:

7. WTO Accession, Pacer Plus and other International Trade Agreements

These are issues which are currently being widely discussed in the local and international arena as well as the local media. There are huge benefits that we can reap from these international agreements. For consumers, it provides them with a wide range of high quality, low priced goods and a variety of services to choose from. On the downside, if our local producers are not well prepared to compete in the local and international markets, they can be driven out of business. The key, therefore, for the local economy is not resistance but investment in innovation and product research.

8. LDC Graduation

I understand that although Samoa has been earmarked for graduation next year, there is a strong possibility that this may be deferred due to the adverse effects of the tsunami on the economy. In which case, we may have a bit more time before we are no longer entitled to soft term financing. Despite this breathing space, the fact remains, Samoa will graduate. And, overseas financing will therefore become more expensive. LDC graduation have significant implications on our development expenditure, revenue earning measures, domestic financial instruments, interest rates, exchange rates as well as economic growth and inflation. We must therefore ensure that when we do eventually graduate, our economy is strong, well diversified and robust enough to generate the necessary resources to finance and support our own development initiatives. In particular, we need to have a very competitive and innovative private sector, with a significant focus on the export market.

9. Cost Effective Provision of Public Utility Services

For the economy to remain competitive, domestically and internationally, the key providers of utility services such as electricity, water and transport need to operate effectively and efficiently. Reliable supply of the key services is critical for not only the sustainable development of the private sector but also the public at large. We need to aggressively pursue the development and usage of alternative sources of energy, capitalizing on our natural resources like the sun, wind, the sea and biomass. This will not only reduce our dependence on imports but increase our foreign exchange reserves as well.

10. Foreign Direct Investment

Foreign Direct Investment (FDI) is slowly trickling into the country. The contribution of FDIs will become increasingly important when we graduate from our LDC status. They bring in additional capital and new technology. Encouraging them to take up partnerships with local investors will enable our local companies to stay competitive and more productive. So far, most of the FDIs that have entered our shores did so, on the lure of substantial tax incentives and other Government assistance. But, we need to get to the stage where FDIs enter on the basis of a strong economic development framework such as a modernized physical and telecommunications infrastructure, robust business and investment climate, competitive financial sector and efficient public sector.

11. Money Laundering and Terrorist Financing

Preventing money laundering and terrorist financing is an ongoing challenge. It is important to safeguard our financial system and our economy from being used for illegal purposes by criminals. Our International Finance Services Centre (SIFA) makes substantial contributions to the Government budget as well as to our economy every year. But, as for other International Finance Centers, there is always the likelihood that some criminals may try to use our Centre to hide illegally gained funds. That is why we have continuously reviewed our legislations and internal control guidelines and procedures to make sure that Samoa is protected from being misused by unscrupulous investors. The challenge for us, however, is trying to keep up with the constantly moving goal posts in relation to the rules and regulations governing the international financial system, especially following the collapse of many financial institutions during the recent global crisis.

12. Containing Inflation

Ladies and gentlemen, one of the biggest challenges that we faced in the recent past has been inflation. The difficulty that we often face is the fact that the bulk of the increase in prices is due to factors beyond our control. These factors include: hikes in crude oil prices, substantial increases in overseas commodity prices, natural disasters affecting supplies, and appreciating foreign currencies. The challenge for the Central Bank is to maintain an exchange rate which reduces imported inflation and debt servicing costs whilst, at the same time, promoting exports and tourism. This is a very tall order!! In any case, the IMF Mission that visited Samoa in October this year confirmed that the exchange rate regime that we have been adopting over the past many years has served Samoa well and continues to be appropriate for our small economy.

13. Other Challenges

The other challenges that will impact the Government Budget, our Social Structure and the Economy as a whole in the near future include: **climate change, unemployment, urban migration and capacity constraint especially in relation to the tourism and agriculture sectors.**

In conclusion, Ladies and Gentlemen, our key challenge now is to revive and stimulate our economy. It is a tough assignment, especially following the tsunami, but we are confident that the programs and policies that have been put in place will help us achieve our objectives.

Our pre-tsunami forecasts pointed to a substantial rebound in the economy in the current financial year from the sharply reduced GDP level of the previous financial year. The tsunami destruction, however, has now changed this outlook. Whilst the huge reconstruction expenditure will provide further stimulus to the economy, tourism is expected to decline as tourists decide to stay away or delay their plans to visit Samoa. Although private remittances increased sharply following the tsunami, that sharp rise coupled with the impact of the global recession on the overseas based Samoan and donor communities is expected to eventually reduce remittances in the future months.

As I said earlier, our international reserves are sitting at a healthy level. And, you probably have heard that the IMF approved last week an amount of about \$20 million to support our reserves in anticipation of the pressure coming from the tsunami reconstruction imports.

We have a mammoth task ahead of us, to stimulate and rebuild our economy following the global recession and the tsunami. But I believe that given the resilience of our People, together with the assistance of the international community, as well as the implementation of appropriate fiscal and monetary policy measures that we now have in place, these will enable the Samoan economy to sail through this storm securely and strongly.

I thank you for your attention
