II. OVERVIEW OF ECONOMIC DEVELOPMENTS DURING THE FOURTH QUARTER OF 2016.

A. The World Economy

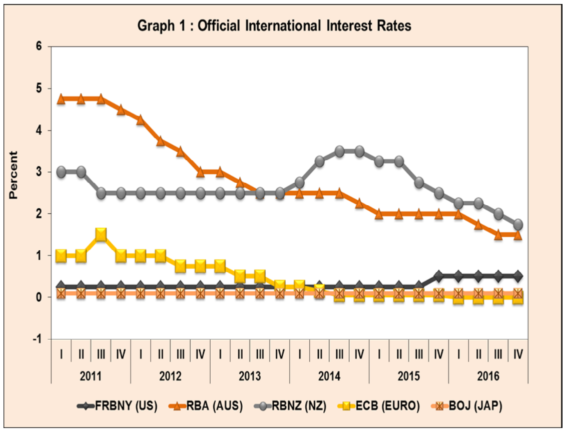
The fourth quarter of 2016 showed some positive signs and a pick-up in economic activity across the global economy. Labour market conditions and inflationary pressures have also gradually improved across most of Samoa's major trading partners. Overall, most monetary authorities maintained accommodative monetary policies in pursuit of sustainable economic recoveries and price stability targets.

The US economy expanded at a slower pace of 2.1 percent in the December quarter according to the third estimate by the US Bureau of Economic Analysis. This was a slowdown in growth from the 3.5 percent expansion in the September quarter following downward revisions to business investment, government spending and inventories offset robust consumer spending. In the labour market, the unemployment rate fell to 4.7 percent in December from 4.9 percent in September as employment numbers improved. Inflationary pressures picked up with the annual inflation rate at 2.1 percent in December, from a reading of 1.5 percent in September due to higher prices for shelter and gasoline. With expectations the inflation will rise to 2.0 percent in the medium term and improvement in labour market conditions, the Federal Reserve Bank of New York (FRBNY) at its December meeting raised its target range for the Federal funds rate by 25 basis points to a range of 0.50 percent to 0.75 percent.

The Australian economy rebounded at a faster than expected pace of 1.1 percent in the December quarter 2016, up from a 0.5 percent contraction in the previous quarter and exceeding market expectations for a 0.7 percent expansion. Economic growth in the fourth quarter was mainly driven by household spending, investment and net trade while government spending was flat. The unemployment rate rose to 5.8 percent in December 2016, from 5.6 percent in September as unemployment numbers increased. Reflecting higher food and housing prices, the annual inflation rate edged up to 1.5 percent to December from 1.3 percent in the previous quarter but was slightly below market expectations of 1.6 percent. With inflation to be consistent with the target over the next one to two years, the Reserve Bank of Australia (RBA) decided to leave its cash rate unchanged at 1.50 percent.

The New Zealand GDP rose by 0.4 percent in the December 2016 quarter, lower than forecasts of 0.7 percent and the previous quarter's growth of 0.8 percent. The increase in the fourth quarter growth was driven by the services sectors (benefiting to some extent from the rapidly rising population), which offset declines in production and manufacturing. In the labour market, the unemployment rate rose to 5.2 percent in December from 4.9 percent in September, and worse than market expectations of 4.8 percent. This was due to strong growth in the labour force as a result of continuously growing of New Zealand's population. The annual inflation rate rose 1.3 percent in December from 0.4 percent in September 2016 reflecting higher prices of newly built houses and fuel. With uncertainty around future outcomes in dairy prices and low inflation, the Reserve Bank of New Zealand (RBNZ) reduced its official cash rate by 25 basis points from 2.00 percent in September 2016 to 1.75 percent during the quarter under review.

The Euro-area economy advanced 0.4 percent in the fourth quarter, slightly above the 0.3 percent growth in the third quarter. The region's GDP growth was driven by positive contributions from the expenditure side as household consumption, gross fixed capital, investments and government spending all increased. Higher manufacturing and services production also contributed to the expansion. The jobless rate declined to 9.6 percent in December from a revised 9.8 percent rate in September 2016. On the other hand, inflation rate edged up 0.5 percent from 0.4 percent in the last comparable period due to higher energy prices. As the Euro-zone experienced improvements in the economy for the consecutive quarter, the European Central Bank (ECB) held its interest rate unchanged at 0.00 percent. (See Graph 1.)

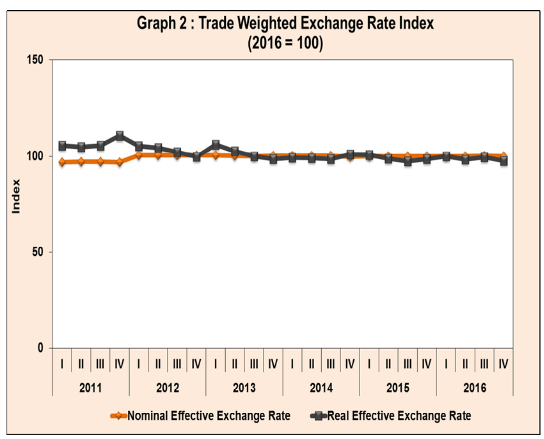


In the United Kingdom (UK), GDP growth for the three months ending December 2016 was revised up to 0.7 percent from 0.6 percent in the last quarter. The economy was mainly driven by upward revisions in the manufacturing industries followed by a sharp rebound in exports and a slight increase in household expenditure, despite a reduction in business investment. Britain's unemployment rate remained unchanged at 4.8 percent from September. The annual inflation rate increased 1.6 percent in the quarter under review from 1.0 percent in the third quarter following higher costs of housing and transportation. Despite the improved economic growth, the Bank of England's bank rate was maintained at a record low of 0.25 percent.

Japanese economic growth edged up to 0.3 percent for the fourth consecutive quarter, beating market expectations of 0.2 percent and the same pace as in the previous period. The expansion in Japan's economy was boosted by exports, government spending and private non-residential investment. In the labour market, the unemployment rate rose to 3.1 percent at end December from 3.0 percent in the three months to September 2016. Similar to the previous period, deflationary concerns continued for the country, with -0.2 percent in December from -0.1 in the last period due to very low costs of transport services and housing. As a result of slow growth for the Japanese economy, the Bank of Japan (BOJ) continued to maintain its negative 0.10 percent interest rate and its annual monetary base at 80 trillion Yen.

China's economy grew slightly less by 1.7 percent in the fourth quarter of 2016 compared to the 1.8 percent in September quarter. On an annual basis, growth was steady at 6.7 percent as investment and consumption softened. Labour market conditions remained favourable as the jobless rate dropped to 4.02 percent compared to the last quarter. In the year to December 2016, consumer prices rose 2.1 percent from 1.9 percent in the year to September due to an increase in politically sensitive food prices and a gain in the cost of consumer goods and services. Reflecting the slow growth in Chinese economy, the People's Bank of China (PBOC) kept its benchmark one year lending rate at 4.35 percent.

In the currency markets, the Greenback was generally strong in the three months ending December 2016 following upbeat economic releases out of the US. Expectations the Federal Reserve will continue to raise interest rates in 2017, worse than expected economic data from around the globe and the fall in commodity prices also weighed down the Australasian currencies. As a result, all the major currencies (particularly, the risky and commodity linked currencies) weakened against the U.S dollar in the quarter under review. (See Graph 2.)



In terms of the Samoan Tala's nominal effective exchange rate (NEER), the overall value of the Samoan currency appreciated against the currency basket by an average 0.12 percent in the year to December 2016. Samoa's real effective exchange rate (REER) appreciated 0.06 percent in the same period.

Note: Information on overseas economies and currencies were sourced from Bloomberg, Westpac Economics updates and Trading Economics website.

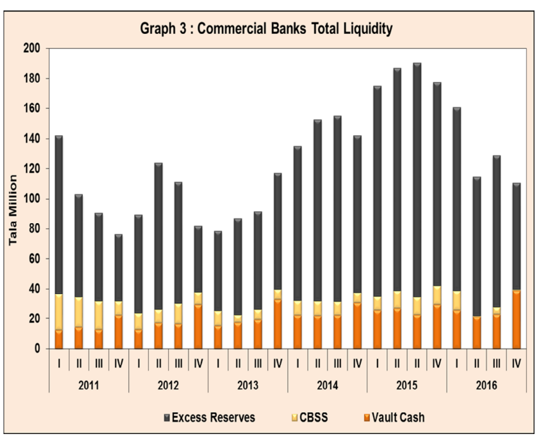
B. The Domestic Economy

The December 2016 quarter saw mixed trends in most macroeconomic indicators. Visitor earnings and private remittances increased in line with seasonal patterns. On the banking side, total commercial bank liquidity contracted while its interest rates remained relatively stable from the previous quarter. Overall, the annual growth rate of Real Gross Domestic Product (RGDP) at the end of December 2016 stood at 5.8 percent.

Monetary Sector

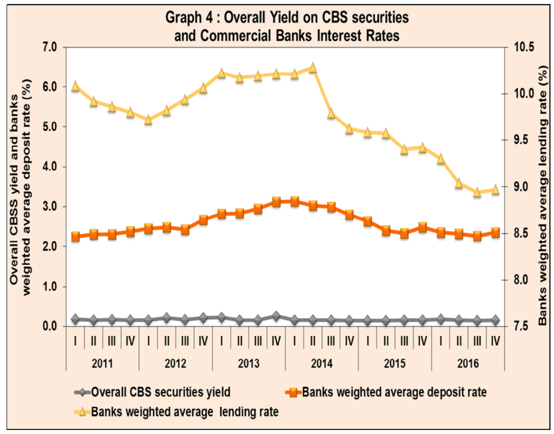
The government's net position closed off the year with a surplus of $22.88 million to $127.05 million in the quarter ending December 2016. At this level, it was also $12.47 million higher than its level in December 2015.

Total banking system liquidity dropped by $18.02 million to $110.59 million from the September 2016 quarter, due to reductions of $29.91 million and $4.00 million in their holdings of exchange settlement account (ESA) and Central Bank of Sāmoa Securities (CBSS) respectively. These were partially offset by an expansion in the banks' vault cash of $15.88 million. (See Graph 3.)

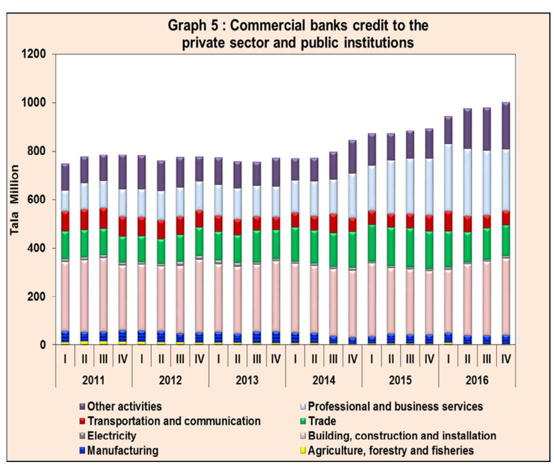


On interest rates, the CBS official policy rate remained at 0.14 percent as in the previous quarter but was slightly lower than 0.15 percent in December 2015. On the other hand, commercial bank interest rates trended upwards with an increase in the weighted average deposit (WAD) rate to 2.36 percent from 2.27 percent a previous quarter.

Likewise, the weighted average lending (WAL) rate inched up to 8.97 percent from 8.94 percent in the September 2016 quarter. However, both rates were lower than their levels of 2.48 percent and 9.42 percent in the December 2015 quarter respectively. (See Graph 4.)



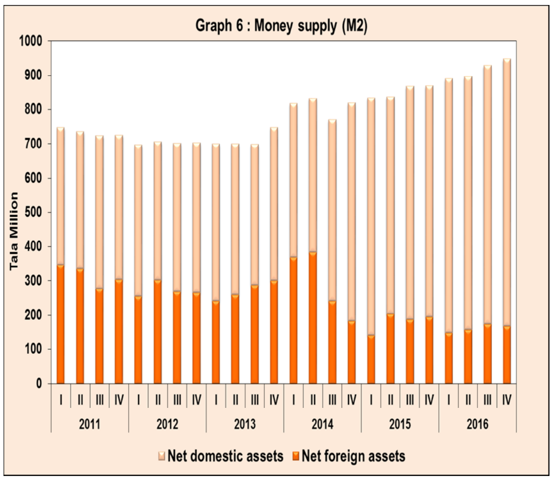
Commercial banks' lending to the private sector and public institutions expanded by $23.03 million to $1,001.60 million and was considerably higher by $109.36 million than in its level in the same quarter of 2015. The increase over the previous quarter was highlighted by improvements in loans to 'other activities', 'building and construction', 'transportation, storage and communication' and electricity, gas and water' sectors. As a result, the annual average credit growth rate increased to 10.2 percent from 9.0 percent in the previous quarter but was slightly lower than 10.5 percent in the December quarter of 2015. (See Graph 5.)



Likewise, total lending of the non-bank financial institutions (NFIs) rose by $48.56

million to $732.51 million in the three months to December 2016. This reflected a significant increase in loans directed to the private sector, which were mainly loans directed to the 'professional and business services', 'other activities', building construction, installation and purchase of land' and 'trade' industries.

All in all, the total broad money[1] increased by $19.19 million to $947.94 million in the last quarter of 2016. This was due mainly to an expansion of $24.84 million in net domestic assets despite a decline of $5.66 million in net foreign assets. Despite an expansion in M2, its annual average growth rate dropped to 6.7 percent from 7.4 percent in the September quarter of 2016, but higher than 5.4 percent in the December quarter of 2015. (See Graph 6.)



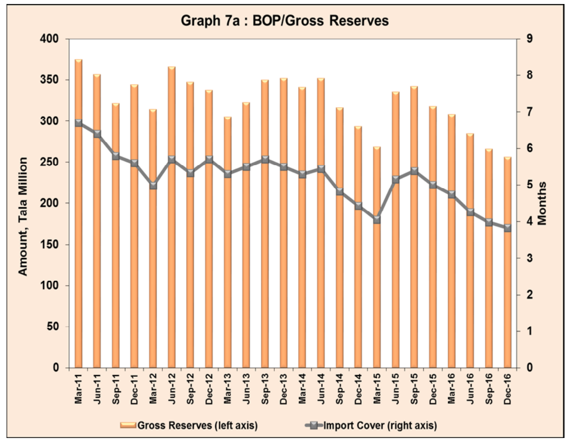
Gross Domestic Product

According to the latest national account figures from the Samoa Bureau of Statistics (SBS), total real gross domestic product (RGDP) in the December 2016 quarter fell by 2.9 percent when compared to the previous quarter or 2.8 percent higher than the same quarter last year. The current performance accounted for reductions in "Transport", "Fishing", "Accommodations and Restaurants", "Other Manufacturing", "Electricity and Water", and "Commerce" sectors to name a few.

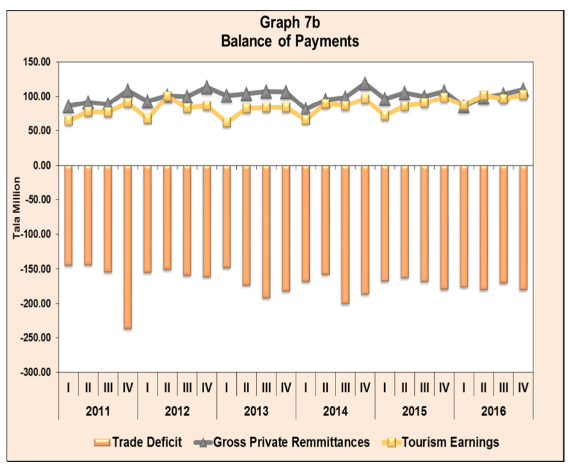
On annual average basis, the annual growth of RGDP fell to 5.8 percent compared to 6.6 percent in the September quarter of 2016. Likewise, nominal GDP per capita also contracted by 2.0 percent to $2,768.3 per capita from $2,825.7 per capita in the previous quarter.

External Sector

The overall balance of payments (BOP) [2] registered a surplus of $5.6 million in the quarter under review following an overall deficit of $6.2 million in the previous quarter. On the other hand, gross official reserves declined by $9.6 million to $256.5 million during the December 2016 quarter, a level sufficient to cover 3.8 months of imports (See Graph 7a.)



The current account balance recorded a surplus in the December quarter due to a large increase in the "Balance on Trade in Services" surplus in the quarter under review. (See Graph 7b.)



The "Trade in Goods" deficit increased, primarily due to a decrease of $6.4 million in exports earnings coupled with an increase in

[1] Also known as Money Supply (M2)

[2] The overall BOP position is not the same as the change in gross official reserves as the overall BOP position takes out exchange rate valuation changes.

import payments of $3.7 million from the previous quarter.

Total exports fell by 22.1 percent (or $6.4 million) in the December quarter due to reductions of $4.0 million and $2.4 million in domestically produced exports and re-exports respectively. By commodities, the lower export proceeds were primarily recorded by fresh fish, nonu juice, nonu fruit, crude coconut oil and copra meal to name a few.

Import payments edged up 1.8 percent to $203.0 million in the current quarter. The slight improvement was fuelled by an expansion of $13.2 million in petroleum imports, offsetting decreases of $6.9 million and $2.6 million in government and non-petroleum private sector imports in that order. In the event, the merchandise trade deficit widened by 6.9 percent (or $4.4 million) in the last quarter of 2016.

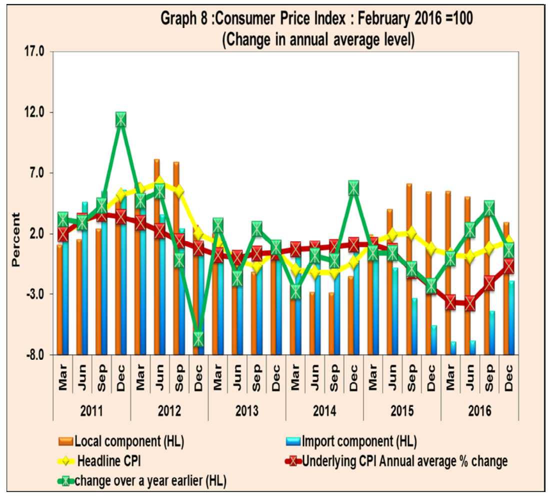
Visitor earnings increased by 6.3 percent (or $6.1 million) to $102.6 million in line with its seasonal trend. This was due to an increase of 7.9 percent in its average expenditure despite a 1.5 percent decline in tourist arrivals during the December 2016. Likewise, total private remittances improved 6.5 percent (or $6.7 million) due to higher inflows for "households" and "other recipients", who were mainly from New Zealand, United States of America and Germany.

Price Developments

The headline Consumer Price Index (CPI) fell by 1.5 percent from the previous quarter but was 0.8 percent higher when compared to the December 2015 quarter.

Underpinning the current decrease in the CPI were reductions of 2.7 percent and 0.4 percent in both its local and imported components respectively. However, the annual average inflation rate rose to 1.3 percent from 0.8 percent in the September quarter of 2016 and was higher than 0.7 percent in December 2015. This reflected an increase in imported inflation to -1.9 percent from -4.4 percent in the previous quarter while domestic inflation slowed to 2.9 percent from 4.1 percent.

Similarly, the underlying CPI dropped by 0.3 percent from the previous quarter but was 1.5 percent higher when compared to the same quarter in 2015. On an annual average basis, the underlying inflation rate edged up to -0.7 percent from-2.1 percent in the previous quarter and -2.4 percent in December 2015. (See Graph 8.)



III. PRUDENTIAL SUPERVISION

For the quarter ended 31 December 2016, the banking system reflected a growth in the level of total assets by 0.7 percent ($9.8 million) to $1,424.4 million whilst total liabilities went up by 0.5 percent ($6.1 million) to $1,191.6 million correspondingly. As compared to the previous twelve months period, both total assets and liabilities recorded outstanding increases of 8.0 percent ($105.0 million) and 7.8 percent ($86.3 million).

The composition of the commercial banks assets is comprised mainly of loans and advances (net) of $885.7 million (67.1 percent of total assets), cash reserves and deposits with the Central Bank and other banks combined at $331.3 million (25.1 percent), fixed assets (net) of $55.5 million (4.2 percent) and other assets at $46.8 million (3.5 percent) in that order.

The composition of the commercial banks assets consist mainly of loans and advances (net) of $1,032.6 million (72.5 percent of total assets), currency and deposits (including cash, reserves and deposits with banks) combined at $273.3 million (19.2 percent), nonfinancial assets of $98.5 million (6.9 percent), debt securities and other assets at $4.0 million (0.3 percent) and $16.0 million (1.1 percent) in that order. Total lending portfolio of $1,066.6 million registered a 2.4 percent ($25.4 million) increase over the previous quarter. On an annual comparison total loans and advances revealed an outstanding increase of 14.1 percent ($132.2 million) respectively. The allocation of loans and advances by sectors during the quarter revealed a growth in loans to households.

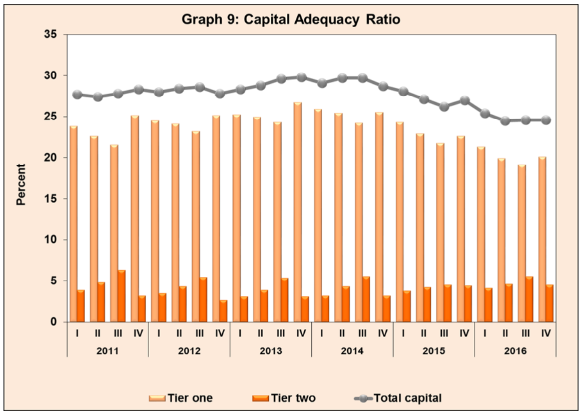
Total deposit liabilities increased by $31.8 million (3.2 percent) over the past three months to $1,034.4 million. Likewise, annual comparison revealed an increase of $67.4 million (7.0 percent) due mainly to the growth in the level of domestic deposits. Time deposits ($483.9 million) represented 46.8 percent of total deposits, demand deposits ($414.6 million) accounted for 40.1 percent while savings deposits ($135.9 million) made up 13.1 percent of total deposit liabilities.

On the other hand, total deposit liabilities of almost $967.0 million increased by 3.3 percent ($30.5 million) over the previous quarter. At this level, it registered an increase of 9.6 percent ($84.8 million) over the same period a year earlier due mainly to the growth in the level of domestic deposits. Time deposits ($445.9 million) represented 46.1 percent of total deposits, demand deposits ($393.4 million) accounted for 40.7 percent while savings deposits ($127.7 million) made up 13.2 percent of total deposit liabilities.

Contingent and off-balance sheet items of $152.9 million (10.7 percent of total assets), indicated a $2.8 million (1.8 percent) decrease over the quarter but grew substantially by $28.4 million (22.8 percent) since December 2015. The significant movement on annual comparison was caused mainly by increases in unused credit commitments and unmatured foreign exchange contracts correspondingly.

At $213.1 million, the banking system's total capital improved by 2.2 percent ($4.6 million) for the period under review. Despite the growth, the capital adequacy ratio of 24.6 percent remained at the same level as compared to September 2016, and continued to stay well above CBS minimum requirement of 15.0 percent.

Tier 1 capital ratio of 20.1 percent also continued to trend comfortably above the CBS minimum requirement of 7.5 percent. (See Graph 9).

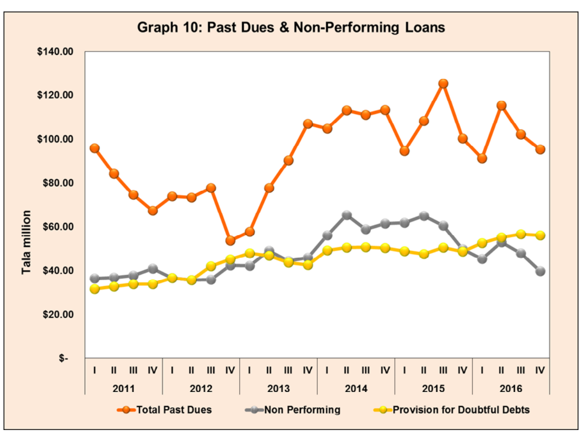


Graph 9: Capital Adequacy Ratio

The overall system liquidity level of $110.6 million indicated a reduction of 14.0 percent ($18.0 million) over the previous quarter and represented 11.3 percent of total domestic deposit liabilities and 17.3 percent of the banking system short term liabilities.

Over the past corresponding twelve months, the banking system's liquidity level dropped significantly by 37.8 percent ($67.1 million). To date, total Central Bank Securities stood at $1.0 million, went down by $12.0 million over the same period a year ago.

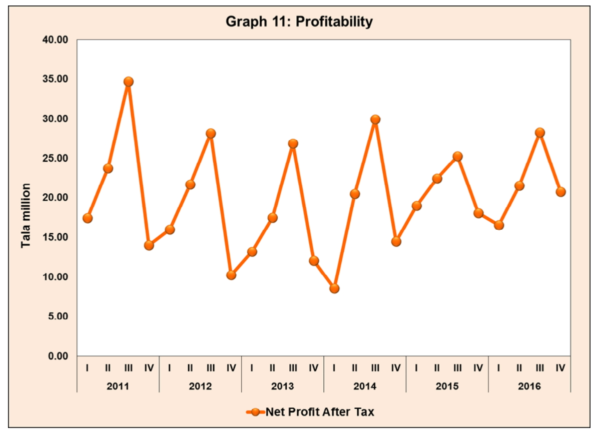
The overall level of non-performing loans (NPLs) of $39.7 million, decreased by 16.9 percent ($8.1 million) over the previous quarter and dropped favorably by 20.2 percent ($10.0 million) over December 2015. (See Graph 10.)



Graph 10: Past Dues & Non-Performing Loans

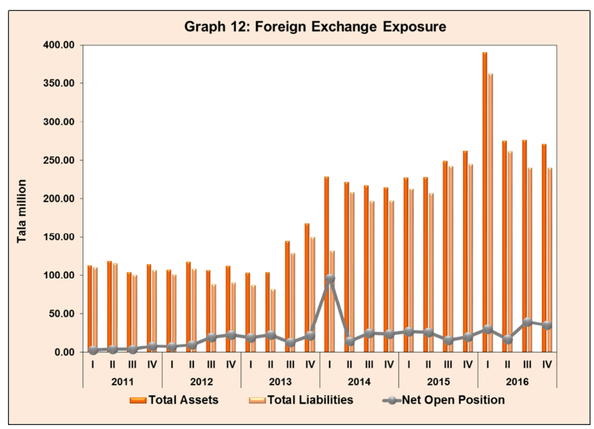
In relation thereto, total specific provisions of $34.0 million provided 85.6 percent coverage of non-performing loans. At the same level, total provision for bad and doubtful debts of $56.0 million accounted for 5.2 percent of total loans and advances and provided sufficient coverage for non-performing loans. At a combined figure of $28.4 million, the banking system's pre tax profit level went up by 14.9 percent ($3.7 million) when compared to the same period a year earlier.

Total net profit after tax of $20.7 million, reflected a return on average networth and average assets of 12.5 percent and 2.0 percent respectively. (See Graph 11).



Graph 11: Profitability

In terms of performance, the banking system efficiency level is reflected at 61.5 percent compared to 58.4 percent registered a year ago. (See Graph 12.)



Graph 12: Foreign Exchange Exposure

The combined foreign assets of the commercial banks amounted to $271.8 million as compared to total foreign liabilities of $239.2 million. At these levels, it showed a net long open position of $35.1 million or 16.5 percent of the banking system's total capital.
