II. OVERVIEW OF ECONOMIC DEVELOPMENTS DURING THE FIRST QUARTER OF 2017.

The World Economy

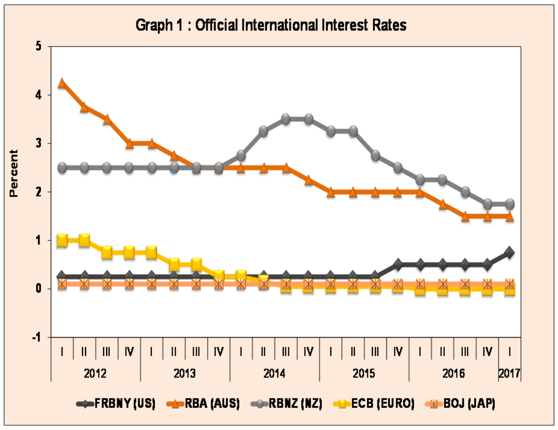
***The first quarter of 2017** continued to show positive signs with a pick-up in economic activity across the global economy. Growth is expected to expand above trend in most economies in the near future. Labour market conditions have improved further with most economies reporting lower than expected unemployment rates. Inflationary pressures continued to pick up 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 grew at a faster than expected pace of 1.2 percent in the March quarter, compared to 0.7 percent in the initial estimates. This was a slowdown in growth from the 2.1 percent expansion in the December 2016 quarter following downward revisions to public spending and investment. In the first three months of 2017, the unemployment rate dropped to 4.5 percent from 4.7 percent in December 2016 as the number of unemployed people declined. The annual inflation rate picked up at 2.4 percent in March, from a reading of 2.1 percent in December 2016 due to higher prices for gasoline. With expectations the inflation will return to 2.0 percent over the medium term and improvement in labour market conditions, the Federal Reserve Bank of New York (FRBNY) raised its interest rate by 25 basis points from 0.50 percent to 0.75 percent in December 2016 to 0.75 percent to 1.00 percent in March.

The Australian economy decelerated 0.3 percent in the March 2017 quarter, down from a 1.1 percent expansion in the previous quarter. Weak net trade and a drop in investments weighed down economic growth in the first quarter. In the labour market, the unemployment rate rose to 5.9 percent in March, from 5.8 percent in December 2016 as unemployment numbers increased. Reflecting higher transportation, food, beverages and housing prices, the annual inflation rate edged up to 2.1 percent in March from 1.5 percent in the previous quarter but was slightly below market expectations of 2.2 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 in this quarter.

The New Zealand GDP rose 0.5 percent in the March 2017 quarter, lower than forecasts of 0.7 percent but slightly up from the previous quarter's growth of 0.4 percent. This favourable performance was mainly driven by the primary sector (a 4.3 percent gain in agriculture production), offsetting declines in construction activity. The unemployment rate dropped to 4.9 percent in March from 5.2 percent in December 2016, and better than market expectations for an unchanged reading of 5.2 percent. This was due to strong growth in the labour force (an increase by around 23,000). The increase in food and transport costs lifted the annual inflation rate to 2.2 percent in March from 1.3 percent in December 2016. With uncertainty around future outcomes in dairy prices and a trend towards its medium inflationary target, the Reserve Bank of New Zealand (RBNZ) left its official cash rate unchanged at 1.75 percent during the quarter under review.

The Euro-area economy advanced 0.5 percent in the first quarter, slightly above the 0.4 percent growth in the fourth quarter. The region's GDP growth was mainly driven by positive contributions from fixed investment and household consumption. In the quarter under review, growth picked up in Germany, Spain and Italy but slowed down in France. The jobless rate declined to 9.4 percent in March from 9.6 percent in December 2016. On the other hand, inflation rate edged up 1.5 percent from 1.1 percent in the last comparable period due to higher energy prices. As the Euro-zone experienced improvements in the economy, the European Central Bank (ECB) held its key interest rate unchanged at 0.00 percent.



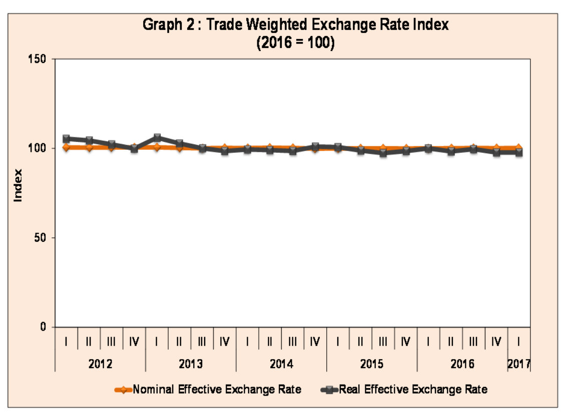
In the United Kingdom (UK), GDP growth for the three months ending March 2017 came in at 0.2 percent, a drop from 0.7 percent in the previous quarter and slightly below market expectations of 0.3 percent. The economic growth was driven by downward revisions in the service sector and a reduction in household spending, despite a rebound in business investment. Britain's unemployment rate fell to 4.6 percent from 4.8 percent in December 2016. The annual inflation rate increased 2.3 percent in the quarter under review from 1.6 percent in the fourth quarter following higher costs of food, alcohol and clothing. With expectations for a pick-up in economic activity in the United Kingdom, the Bank of England decided to maintain its official rate at a record low of 0.25 percent.

Japanese economic growth edged up to 0.3 percent in the first quarter, below initial estimates of 0.5 percent expansion and the same pace as in the previous period. The expansion in Japan's economy was supported by improvements in private consumption. In the labour market, the unemployment rate fell to 2.8 percent at end March from 3.1 percent in the three months to December 2016. Inflationary pressures were modest with the annual inflation rate at 0.2 percent in March, from a reading of 0.3 percent in December 2016 due to higher prices for food and transport. Given the slow growth in 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 by 1.3 percent in the first quarter of 2017 compared to 1.7 percent in December 2016 quarter. The increase in economic growth was driven by increases in manufacturing, investment and construction activity. Labour market conditions remained favourable as the jobless rate dropped to 3.97 percent compared to 4.02 percent in the last quarter. In the year to March 2017, consumer prices rose 0.9 percent compared to 2.1 percent in the year to December 2016 due to a decrease in food prices. 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 weakened in the first quarter of 2017 following the release of downbeat economic releases in the US. Expectations the Federal Reserve will avoid hiking its key interest rates too quickly in 2017, uncertainty surrounding the impact of U.S President Trump's policies on the U.S economy and the rise in equity and commodity prices underpinned the strength in the Australasian currencies. As a result, all the major currencies (particularly, the risky and commodity linked currencies) appreciated against the U.S dollar in the quarter under review.

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 0.17 percent in the year to March 2017. On the other hand, Samoa's real effective exchange rate (REER) depreciated 0.34 percent in the same period.



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

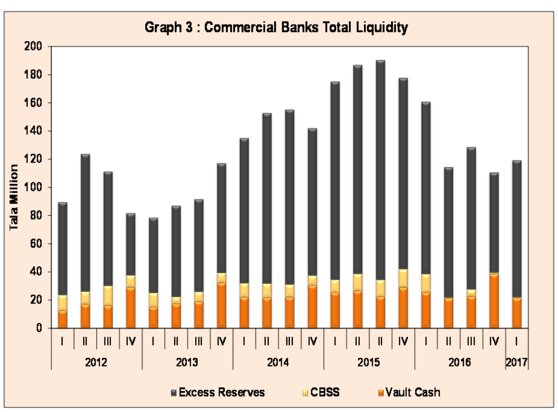
B. The Domestic Economy

Macroeconomic indicators in the first quarter of 2017 exhibited mixed developments with most following their seasonal trends. Following the end of year festivities in the previous quarter, tourism earnings, private remittances and consumer demand slowed in the March 2017 quarter. With the continuing reduction in interest rates, commercial banks' total lending expanded further. Inflation dropped slightly while the Real Gross Domestic Product (RGDP) registered a 4.2 percent annual growth.

Monetary Sector

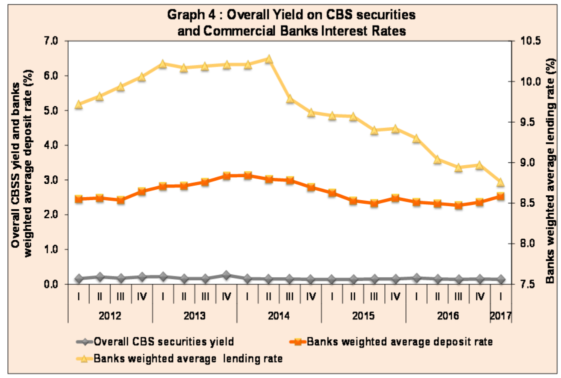
The government's net position with the monetary system registered a huge surplus of $33.1 million to $160.2 million in March 2017 over the December quarter of 2016, or $53.3 million higher than the March 2016 quarter.

Commercial banks' liquidity picked up by $8.7 million to $119.2 million in light of a $26.1 million expansion in commercial banks' exchange settlement accounts (ESA) despite reductions of $16.9 million and $0.5 million in banks' vault cash and holdings of CBS securities respectively. (See Graph 3.)



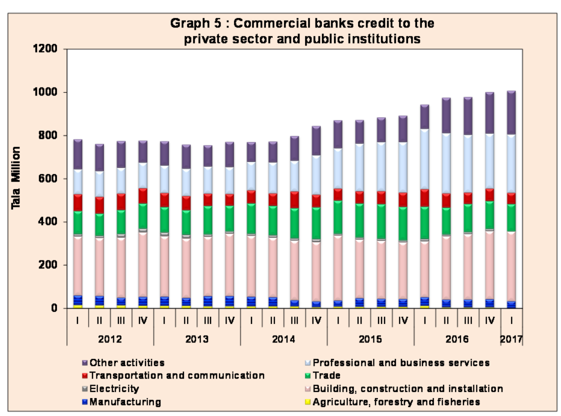
Graph 3 : Commercial Banks Total Liquidity

Interest rates recorded mixed performances with the official interest rate remaining at 0.14 percent as in the previous quarter but below 0.18 percent in March 2016. On the other hand, the commercial banks weighted average deposit (WAD) rate increased by 17 basis points to 2.53 percent in the first quarter of 2017 in light of relatively tight institutional liquidity. In contrast, the weighted average lending (WAL) rate dropped 21 basis points to 8.76 percent in March 2017, which was also lower than 9.30 percent in the same month last year. (See Graph 4.)



Graph 4 : Overall Yield on CBS securities and Commercial Banks Interest Rates

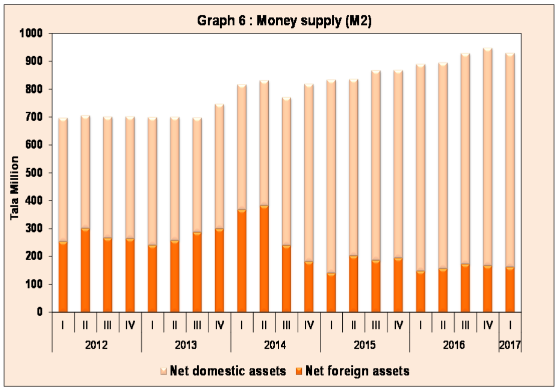
Due to the further drop in lending rates, total commercial banks' credit to the private sector and public institutions combined expanded by $21.3 million to $1,022.9 million, a level that was also $79.2 million higher than in the first quarter of last year. Underpinning this increase was a $23.9 million expansion in the private sector credit, while those extended to public institutions slightly dropped by $2.6 million. The expansion accounted for improvements in lending directed to 'Professional and business services', Electricity gas and water', 'Building construction and installation', 'Other activities' and 'Agriculture, forestry and fisheries' sectors. Consequently, the annual average growth rate of bank lending increased to 11.3 percent from 10.2 percent in the December 2016 quarter and 9.1 percent in the March 2016 quarter. (See Graph 5.)



Graph 5 : Commercial banks credit to the private sector and public institutions

In contrast, total lending of non-banks financial institutions contracted by $3.8 million to $728.8 million in the quarter under review, highlighted by decreases in lending to both public institutions and the private sector.

However, total broad money[1] contracted by $18.1 million to $929.9 million reflecting reductions of $12.9 million and $5.2 million in net domestic assets and net foreign assets respectively. Consequently, the annual average growth of money dropped from 6.7 percent in the previous quarter to 6.2 percent in the March quarter. (See Graph 6.)



Gross Domestic Product

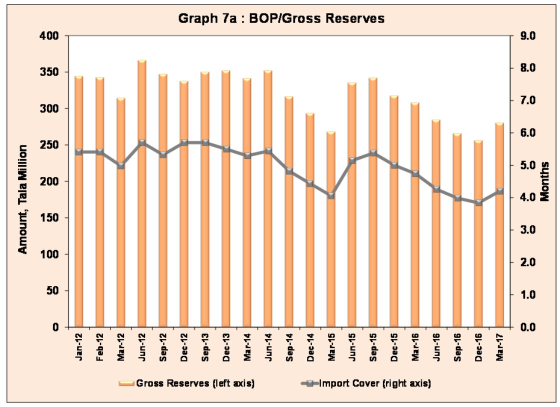
According to the latest national account figures from the Samoa Bureau of Statistics (SBS), total real gross domestic product (RGDP) in the March quarter contracted by 4.5 percent when compared to the previous quarter but was 1.5 percent higher than the same quarter last year. This drop over the previous quarter was accounted for by seasonal reductions in "Food & Beverages manufacturing", "Fishing", "Accommodations and Restaurants", "Construction", "Financial Services" "Business Services", "Other Manufacturing" "Public administration" and "Personal and other services" sectors.

Nevertheless, the annual growth rate of RGDP slowed to 4.2 percent compared to 6.5 percent in the December quarter of 2016 and 5.5 percent in the March 2016 quarter. Likewise, nominal GDP per capita also contracted by 1.9 percent to $2,715.6 per person from $2,768.7 per person in the previous quarter. For the twelve months to March 2017, nominal GDP per capita ($10,915.1 per person) was 4.8 percent higher than the same period up to March 2016.

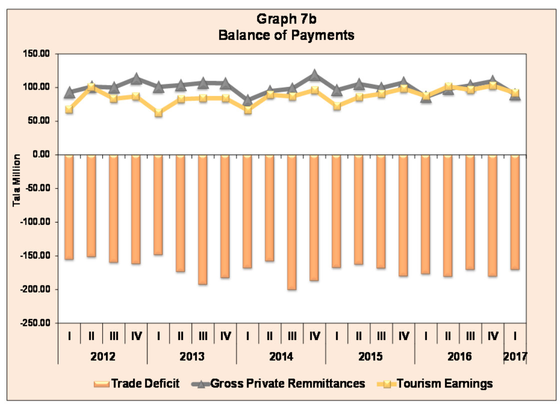
[1] Also known as Money Supply (M2)

External Sector

The overall balance of payments (BOP) registered a surplus[2] of $2.5 million in the quarter under review on top of another surplus of $5.6 million in the previous quarter. As a result, gross official reserves jumped by $24.2 million to $280.2 million, a level that was sufficient to cover 4.2 months of imports (See Graph 7a.)



The current account balance recorded a deficit in the March quarter due to a large drop in the "Balance on Trade in Services" surplus in the quarter under review given the seasonal decline in travel credit (tourism earnings). (See Graph 7b.)



The Balance on Trade in Goods contracted over the previous quarter due to a $13.8 million drop in import payments despite a decrease of $3.6 million in export earnings.

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

Total exports fell by 16.2 percent in the March quarter due to a $4.7 million reduction in domestically produced exports. These were primarily fresh fish, coconut cream, beer, nonu juice, and taro to name a few.

Import payments also edged down 6.8 percent to $189.2 million. This was accounted for by a decline of $24.7 million in non-petroleum private sector imports, offsetting increases of both $9.3 million and $1.6 million in government and petroleum imports respectively.

Total visitor arrivals in the March quarter are not yet available, however, careful CBS estimates project a seasonal 21.8 percent drop after the yearly peak in the December quarter. As a result, visitor earnings are expected to decrease by 13.3 percent to $91.7 million in line with its seasonal trend.

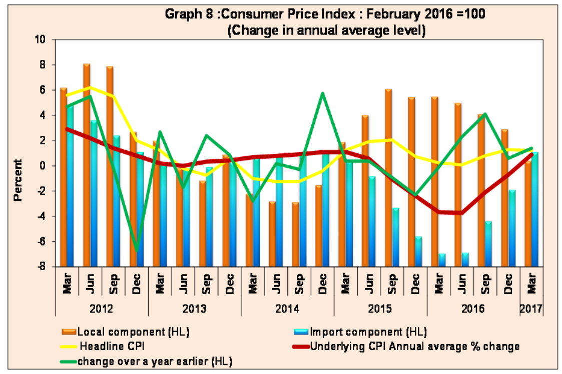
Similarly, total private remittances dropped by a seasonal 18.1 percent in March quarter. Primarily underpinning the overall decline in private remittances were reductions in funds sent from Australia, New Zealand, American Sāmoa and the United States of America.

Price Developments

The headline Consumer Price Index (CPI) bounced back by 0.8 percent from the previous quarter and was 0.03 percent higher when compared to the March 2016 quarter.

Contributing to the current increase in the CPI were expansions in both its local and imported components by 1.0 percent and 0.7 percent respectively. However, the annual average inflation rate fell slightly to 1.2 percent from 1.3 percent in the December 2016 quarter but was higher than 0.2 percent in March 2016. This reflected a decrease in domestic inflation to 0.4 percent from 2.9 percent in the previous quarter while imported inflation grew to 1.1 percent from -1.9 percent.

Similarly, the underlying CPI fell further by 0.4 percent from the previous quarter but was 1.8 percent higher when compared to the same quarter in 2016. On an annual average basis, however, the underlying inflation rate increased to 0.9 percent from -0.7 percent in the previous quarter and -3.7 percent in March 2016. (See Graph 8.)



III. PRUDENTIAL SUPERVISION

For the quarter ending 31 March 2017, the banking system recorded strong growth in the level of total assets by 2.6 percent ($37.6 million) to $1,462.0 million whilst total liabilities went up by 2.5 percent ($29.6 million) to $1,221.1 million correspondingly. When compared to the previous twelve months period, both total assets and liabilities also registered significant increases of 7.3 percent ($99.4 million) and 6.2 percent ($71.1 million) in that order.

The composition of the commercial banks assets consist mainly of loans and advances (net) of $1,053.9 million (72.1 percent of total assets), currency and deposits (including cash, reserves and deposits with banks) combined at $264.6 million (18.1 percent), nonfinancial assets of $103.9 million (7.1 percent), debt securities and other assets at $22.4 million (1.5 percent) and $17.2 million (1.2 percent) in that order.

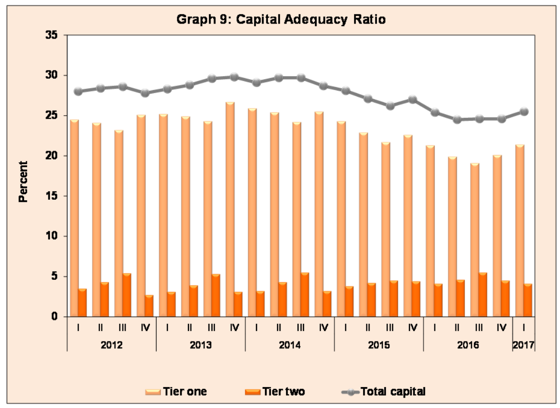
Total lending portfolio of $1,088.9 million registered a 2.1 percent ($21.2 million) increase over the previous quarter. On an annual comparison total loans and advances revealed an outstanding increase of 11.2 percent ($110.1 million) respectively. The allocation of loans and advances by sectors during the quarter revealed a growth in loans to businesses and households.

Total deposit liabilities increased by $19.5 million (1.9 percent) over the past three months to $1,053.9 million. Likewise, annual comparison revealed an increase of $90.9 million (9.4 percent) due mainly to the growth in the level of domestic deposits. Time deposits ($519.4 million) represented 49.3 percent of total deposits, demand deposits ($402.1 million) accounted for 38.1 percent while savings deposits ($132.4 million) made up 12.6 percent of total deposit liabilities.

Contingent and off-balance sheet items of $141.7 million (9.7 percent of total assets), indicated an $11.1 million (7.3 percent) decrease over the quarter and further declined by $36.1 million (20.3 percent) since March 2016. The significant movement on annual comparison was caused mainly by decreases in unused credit commitments and transaction related items correspondingly.

At $220.4 million, the banking system's total capital improved by 3.4 percent ($7.3 million) for the period under review. To date, the capital adequacy ratio of 25.5 percent went up by 0.9 percent over December 2016, and continued to stay well above CBS minimum requirement of 15.0 percent.

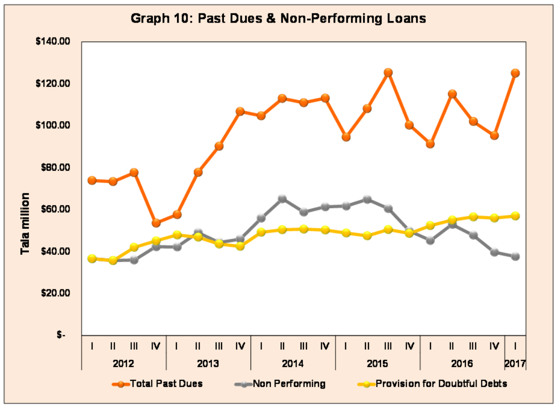
Tier 1 capital ratio of 21.4 percent also continued to trend comfortably above the CBS minimum requirement of 7.5 percent. (See Graph 9).



The overall system liquidity level of $119.2 million indicated an improvement of 7.8 percent ($8.7 million) over the previous quarter and represented 12.4 percent of total domestic deposit liabilities and 23.3 percent of the banking system short term liabilities.

Over the past corresponding twelve months, the banking system's liquidity level dropped significantly by 25.8 percent ($41.5 million). To date, total Central Bank Securities stood at $0.5 million, went down by $12.5 million over the same period a year ago.

The overall level of non-performing loans (NPLs) of $37.7 million, decreased by 5.2 percent ($2.1 million) over the previous quarter and dropped favorably by 16.9 percent ($7.7 million) over March 2016.

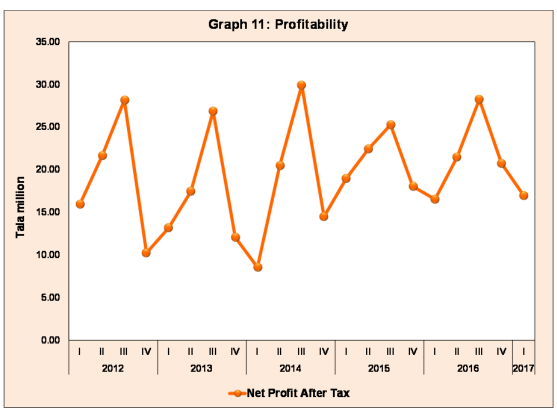


Graph 10: Past Dues & Non-Performing Loans

In relation thereto, total specific provisions of $35.1 million provided 93.1 percent coverage of non-performing loans. At the same level, total provision for bad and doubtful debts of $56.9 million accounted for 5.2 percent of total loans and advances and provided sufficient coverage for non-performing loans.

At a combined figure of $23.1 million, the banking system's pre tax profit level edged up by 1.0 percent ($0.2 million) when compared to the same period a year earlier.

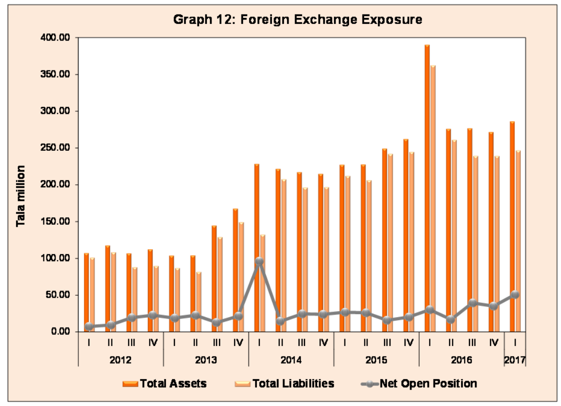
Total net profit after tax of $16.9 million, reflected a return on average networth and average assets of 39.0 percent and 6.4 percent respectively. (See Graph 11.)



Graph 11: Profitability

In terms of performance, the banking system efficiency level is reflected at 66.2 percent compared to 62.6 percent registered a year ago.

The combined foreign assets of the commercial banks amounted to $286.2 million as compared to total foreign liabilities of $246.8 million. At these levels, it showed a net long open position of $50.8 million or 23.1 percent of the banking system's total capital.



Graph 12: Foreign Exchange Exposure
