1. INTRODUCTION

In line with the Central Bank's Corporate Plan for 2003–2005 and Government's Strategy For The Development of Samoa for 2003-04, the main objective for the Central Bank's monetary policy is to promote sustainable real economic growth by maintaining price stability and international reserves viability.

The Central Bank has defined price stability as an inflation rate consistent with those of Samoa's main trading partners. The annual rates of inflation for Samoa's main trading partners average around 3.0 percent and this is the target that the Central Bank normally aims to achieve and maintain each year. However, there are times when changes to prices are beyond the realms of monetary policy, indeed beyond the authority of the Central Bank. This was the case in the past two financial years where a number of significant factors influenced Samoa's annual rate of inflation. These included the sharp and continually increasing international price of crude oil, the adjustment of prices subject to price control regulations (e.g. the upward adjustment in the regulated fares for buses and taxis in July 2001 and the official prices for beer and cigarettes in June 2002 and June 2003 and water rates in July 2003) and changes to the VAGST rate (effective October 2002).

Given that Samoa is a very small open economy with total merchandise trade alone representing around 60 percent of nominal GDP, it is very important that Samoa maintains a sufficient level of international reserves to withstand large unforeseeable economic shocks. The Central Bank considers a level of net international reserves equivalent to no less than 4.0 months of imports of goods as adequate for maintaining the country's long-term economic stability.

2. OVERVIEW

According to data published by the International Monetary Fund in its April 2003 World Economic Outlook, the world economy grew by 3.1 percent in real terms in the twelve months to end June 2003, which was an improvement over the 2.7 percent real growth rate that was recorded for the period up to end June 2002. The world inflation rate, on the other hand, declined to 1.7 percent in the year to end June 2003 from 1.9 percent in the previous twelve months. The improvement in growth around the world in the fiscal year 2002/03 was, however, lower than expectations due to sluggish economic performances by USA, Japan and the Euro area. Growth momentum is, in any case, expected to strengthen in 2003/04, led by an expected pick up in economic activities in the advanced economies including Samoa's main trading partners New Zealand and Australia. The stronger growth in 2003/04, however, would also see world inflation edge up slightly.

On the domestic front, the Samoan economy performed well in fiscal year 2002/03. Much of this remarkable performance occurred in the first quarter of 2003. Inflation, which accelerated in the first half of fiscal year 2002/03, subsided in the second half consequent to an improvement in local food supplies. The balance of payments recorded a large overall deficit but international reserves remained at a relatively healthy level. The macro-economic outlook for 2003/04 remains stable with inflation continuing to decline and reserves holding up comfortably. In addition, the start of some major construction projects in the private and public sectors is expected to generate further growth in economic activity in 2003/04 with real GDP expected to expand between 2 and 3 percent. To sustain this growth momentum in 2003/04, therefore, monetary policy will be eased to allow more credit for private sector development.

3. RECENT DEVELOPMENTS

3.1 World Economy

World economic activity is still on a slow rebound, contrary to the optimism that it would recover to full strength by 2003. The global economy grew in real terms by 3.1 percent in fiscal year 2002/2003 compared to forecasts of around 3.4 percent. However, a more promising outlook is expected in the second half of 2003 with a forecast of 3.7 percent real growth anticipated for fiscal year 2003/2004. Inflation, on the other hand, is forecast to increase to 1.8 percent. (See Table 1.)

Table 1
Selected World Economic Indicators

Fiscal year to end June	2000/01	2001/02	2002/03	2003/04 Forecast	
		(Percent)			
Real growth rate	3.6	2.7	3.1	3.7	
Inflation rate	2.3	1.9	1.7	1.8	
Official international interest rates,		(End of period, percent p.a.)			
US Federal Reserve	3.75	1.75	1.00	1.00	(1)
Reserve Bank of Australia	5.00	4.75	4.75	4.75	(2)
Reserve Bank of New Zealand	5.75	5.75	5.25	5.00	(3)
Bank of Japan	0.25	0.25	0.15	0.15	(4)
Bank of England	5.25	4.00	3.75	3.50	(5)
European Central Bank	5.25	3.25	2.00	2.00	(6)
Reserve Bank of Fiji Notes, 91 days	1.43	1.25	1.25	1.25	(4)

Source: IMF and reserve banks' publications and information releases.
(1) Interest rate as at 12th August 2003
(2) Interest rate as at 6th August 2003
(3) Interest rate as at 24th July 2003
(4) Interest rate as at 30th June 2003
(5) Interest rate as at 10th July 2003
(6) Interest rate as at 04th September 2003

The US economy has only just begun to show stronger signs of a broad-based expansion following its recent uneven and sluggish recovery from the 2001 recession. Real GDP in the June quarter of 2003 was up 0.6 percent compared with 0.4 percent in the previous quarter, compliments of stronger manufacturing output in May and June. Domestic demand was sustained through consumer spending (which was up by 0.8 percent in the June quarter) and residential investment. Both consumer spending and residential investment were spurred on by low interest rates, the boom in house prices and strong growth in disposable incomes. Business investment and employment figures remain weak but recent data have been positive. However, strong import numbers and higher world oil prices following the war in Iraq saw the US current account deficit balloon to 5¼ percent of GDP in the first quarter of 2003. Not helping the current account deficit was a decline in private capital inflows due to less favorable interest rate differentials and weaker global sentiment towards US equities.

The Australian economy remains resilient despite poor developments in the global economy. Domestic sectors such as housing and business surveys are powering along while export figures remain soft due to weak global demand together with the other sectors that are exposed to the global economy. Domestic demand has been encouraging, expanding by 5½ percent over the latest four quarters. The progress in employment numbers has been around trend, though lower in recent months. Inflation, on the other hand, is currently 2¾ percent, slightly above the target mid-point.

The New Zealand economy has been strong and comparatively stable but economic growth slowed recently due to falling farm incomes, the strong kiwi dollar, labour shortages, drought, electricity crisis, SARS, easing net immigration and high pessimism. However, this economic slow down was cushioned by the latest economic indicators showing that the unemployment rate has fallen to 4.7 percent, business pessimism has somewhat eased, consumer confidence looking more hopeful and an improvement in tourist numbers by 7 percent in June.

The Japanese economy continues to experience deflation, with consumption, housing investment, and net exports flat. Business investment, however, rose strongly in the March quarter of 2003, despite little growth in production. The labour market remains weak as the unemployment rate continues to hover around 5 ¼ to 5 ½ percent. Japan's CPI fell 0.4 percent over the year to end June compared with falls of nearly 1 percent in the past few years as some temporary factors have slowed the decline in consumer prices.

The Euro area economy continues to be the worst performing large industrialized area. The labour market is currently in a poor state together with consumer confidence at low levels. Export figures remain weak partly due to the appreciation of the euro as investment spending continues to contract. Industrial production declined in recent months alongside a renewed weakness in business sentiment. These unfavourable conditions are particularly evident in Germany and France, two of the core euro economies.

Macroeconomic policy around the world has been expansionary following the failure of global activity to pick up pace in the first half of 2003. The US Federal Reserve Bank now has its official interest rates at an all-time low of 1.00 percent from 1.25 percent earlier in the year. This level could be cut further if the Federal Reserve feels the US recovery is not gaining momentum. In Europe, the European Central Bank and the Bank of England, have their interest rates at 2.00 percent and 3.50 percent respectively, from 2.50 percent and 3.75 percent earlier in the year. Across the Pacific, the Reserve Bank of New Zealand (RBNZ) and the Reserve Bank of Australia (RBA) reversed their tight monetary policy stance from the previous year. The RBNZ has cut its official cash rate to 5.00 percent, down 50 basis points from earlier in the year. The RBA, on the other hand, is the only Reserve Bank to have continued its monetary policy stance from the start of the year by maintaining its official rate at 4.75 percent, citing support from a resilient domestic economy.

On exchange rates, the US dollar's strength from its ability to attract capital in the form of foreign direct investment and purchases of equities and corporate bonds was really damaged in the first half of the year. The US dollar has fallen 18 percent by early July 2003 since its peak in late January 2002. A low interest rate, together with poor economic fundamentals from a weak US economy further weakened global sentiment towards holding US assets, and consequently US dollars. Investors have, therefore, been averse to holding US dollars and have turned to the commodity currencies of New Zealand and Australia, which have had higher yields so far. Against the euro, the greenback has recently made some gains but they are far from impressive.

The Australian (AUD) and New Zealand (NZD) dollars have continued their strength from the previous year, reaching fresh five-year highs against the greenback of 68 US cents and 60 US cents respectively in July 2003. This was due to an extremely weak US dollar and strong domestic economies. Both currencies have since come off these highs, with the NZD trading in the upper end of 58 US cents and the AUD trading in the lower end of 65 US cents, in August 2003.

The Yen remains well bid against the US dollar, trading in the Yen 117-120 range, in August 2003. Currency traders are still cautious of bidding up the currency due to possible intervention attempts by the Japanese officials to weaken the unit, as they have been very aggressive in selling the Yen. In May 2003 alone, over 1 trillion Yen was spent in stabilizing the currency, in an effort to stimulate Japan's stagnant export sector.

3.2 Domestic Economy

Based on the latest figures and historical trends, a real GDP growth rate for the fiscal year to end June 2003 is estimated at 4.3 percent. (See Table 2.) Much of this growth reflected the very strong real growth rate achieved in the March 2003 quarter. Although it fell 1.6 percent from the usual hype in activity associated with the end of year festivities in the December quarter of 2002, real GDP in the March 2003 quarter grew 6.1 percent when compared with the same quarter in 2002. This remarkable result reflected growths in all sectors except for the "Agriculture", Fishing" and "Construction" sectors, which declined. Substantial growths were recorded in "Food and beverages manufacturing" (43.4 percent), "Other manufacturing, including Yasaki" (14.7 percent), "Hotels and restaurants" (14.6 percent), "Transport and communication" (9.0 percent) and "Commerce" (6.4 percent). In addition, "Finance and business services" expanded 5.9 percent, "Professional and other services" grew 5.0 percent and the output of the "Electricity and water" sector improved 4.2 percent. On the other hand, the output of the "Construction" sector, which had been the main source of economic growth in recent years, declined 6 percent reflecting the winding down of some major Government infrastructure projects. A potent combination of sharply reduced export prices and catch yields saw the output of the "Fishing" industry decline 3.1 percent in first quarter of 2003. In fact, for the twelve months to end June 2003, the export price of fish fell 10 percent and the volume of fish exports dropped 27 percent. The reduction in fish prices reflected the weak demand for fish products in the USA as well as the decline in the value of the US dollar. The output of the "Agriculture" sector went down marginally in the first quarter of 2003.

The actual figures on Government's financial operations for the fiscal year to June 2003 are not yet available. However, an overall deficit of $17.5 million (in GFS Format) was budgeted for the fiscal year 2002/03 representing 1.9 percent of nominal GDP. The latest figures showed that Government recorded a cash surplus of $6.2 million in its financial operations during 2002/03, raising its net position with the monetary system to $99.2 million.

Table 2
Selected Domestic Economic Indicators

Fiscal year to end June	2000/01	2001/02	2002/03	2003/04 Forecast	
	(Percentage change over the previous year)				
Real sector					
Nominal GDP	12.5	5.2	7.2	4.5	
Real GDP	8.6	2.2	4.3	2.5	
Prices					
Consumer Price Index (annual average)	1.9	7.4	4.3	2.3	
Implicit GDP Deflator (annual average)	3.6	3.0	2.9	2.0	
Monetary aggregates					
Net foreign assets (end of period)	0.8	1.3	-9.2	-2.1	
Government's net monetary position (end of period)	-11.8	5.2	6.7	-1.0	
Bank credit to private sector					
Annual average	18.8	14.9	10.7	10.0	
End period	21.1	9.9	11.4	9.3	
Money Supply, M2					
Annual average	16.2	7.6	5.3	6.7	
End period	20.1	3.6	6.6	3.7	
Exchange rate					
Nominal Exchange Rate	1.45	-1.52	-2.17	na	
Real Exchange Rate	-0.25	3.05	-1.25	na	
International reserves	(Level at period end)				
Net foreign assets (Tala million)	179.9	182.2	165.5	162.0	
Net foreign assets (Months of merchandise imports)	5.2	4.7	4.7	4.2	
Weighted average interest rates	(End of period, percent p.a.)				
CBS 14 days Securities (1)	-	3.05	2.29	2.29	(2)
CBS 28 days Securities	4.85	4.00	4.00	3.31	(4)
CBS 56 days Securities	4.71	4.75	4.75	4.41	(4)
CBS 91 days Securities	5.60	5.50	5.50	5.40	(4)
CBS 182 days Securities	6.50	6.90	6.90	6.69	(3)
CBS 365 days Securities	7.00	7.06	7.06	6.90	(2)
Commercial bank deposits	4.5	4.4	4.4	4.4	(5)
Commercial bank credit	11.7	11.6	11.6	11.3	(5)
Commercial bank interest rate spread	7.2	7.2	7.2	6.9	(5)

Source: Central Bank of Samoa
(1) These securities were first issued on 22 February 2002
(2) Interest rate as at end March 2003
(3) Interest rate as at end May 2003
(4) Interest rate as at end August 2003
(5) Interest rate as at end July 2003

On the external side, the balance of payments recorded a substantial overall deficit of $16.7 million in the year to end June 2003 in contrast to a small overall surplus of $2.3 million in 2001/02. A number of significant factors contributed to the adverse outcome in 2002/03. As mentioned earlier, the export price and volume of fish exports fell dramatically in 2002/03, reducing the value of fish exports by 34 percent. Furthermore, export earnings from garments dropped 25 percent due also to weak demand in the main market USA. These large reductions were partially offset by large shipments of coconut oil and copra meal as well as increased earnings from beer (up 19 percent), nonu products (up 27 percent), taro (up 31 percent), coconuts (up 73 percent) and banana (up 35 percent). Total exports therefore went down 17 percent to $41.3 million in 2002/03. On the other hand, earnings from tourism improved 7 percent to $155 million, revenues for Yazaki jumped 68 percent to $23 million and the net inflow of private remittances edged up to $176 million.

In addition to the reduction in export earnings, the net inflow of loan disbursements for Government declined 60 percent ($6.9 million) in 2002/03 reflecting the winding down of projects as mentioned earlier. There were also some exceptional outflows of foreign exchange during the year. These were substantial overseas payments by Polynesian Airlines for the early return of one of its aircrafts ($10 million) and the remittance of proceeds from the sale of some large real estate assets to Nauru ($5 million) plus some other private real-estate owners who are now residing abroad. In addition, an increase in dividend payments overseas by Telecom Samoa Cellular and the commercial banks as well as interest payments on overseas debt also contributed to the large balance of payments deficit in 2002/03. These substantial increases in overseas payments were partially offset by a large reduction in imports, which went down 9 percent to $424 million. Imports by the Government dropped 69 percent to $8 million, private sector imports fell 9 percent to $356 million while petroleum imports grew 26 percent to $60 million.

Despite the substantial overall balance of payments deficit, the sizable reduction in imports saw the level of net foreign assets remain at the equivalent of 4.7 months imports of goods, the same as at the end of June 2002.

On prices, the annual rate of inflation (which is measured using the Consumer Price Index) accelerated in the first half of fiscal year 2002/03 reaching 8.3 percent in November 2002 before subsiding, as expected, to 4.3 percent at the end of June 2003. The increase in the VAGST rate from 10.0 percent to 12.5 percent in October 2002 appears to have had little discernible effect on inflation in 2002/03. In fact, inflation in 2002/03 was largely driven by the increase in local food prices (up 9.5 percent) whereas the imported food component of the CPI fell (down 1.4 percent). The hike in local food prices reflected the generally unfavourable weather conditions, which impacted adversely on the production and harvest of the main agricultural commodities, particularly vegetables. Significant rises in the "Alcohol and tobacco" sub-index (up 14.1 percent) due to a rise in the prices of beer and cigarettes and the "Transport and communication" sub-index (up 4.5 percent) due to the increase in petroleum prices further contributed to the sharp expansion in the annual rate of inflation in the first half of fiscal year 2002/03. Nevertheless, at 4.3 percent, the rate of inflation at end June 2003 was lower than the inflation rate of 7.4 percent at end June 2002.

4. THE WORLD ECONOMY IN 2003/2004

The outlook for the world economy, according to the IMF, for 2003/2004 is for growth of around 3.7 percent, slightly higher than the 3.1 percent recorded in the preceding year while the world inflation rate is set to edge up marginally to 1.8 percent from 1.7 percent.

The forecast for global economic expansion is based on the emergence of several pro-growth factors. One of these is the release of encouraging data out of the USA, which have resulted in gains in equity markets and bond yields. In addition, a more expansionary stance on macroeconomic policy by the major central banks and governments around the world has provided additional stimulus to the global economy. The end of the war in Iraq and the removal of travel restrictions associated with the SARS epidemic have also been seen as supportive of growth prospects. Despite these positive indicators, the projections for world economic growth could be unsettled easily by terrorism and heightened geopolitical tension in Asia, particularly in the Korean peninsular and the Middle East.

The ***US economy*** is now on track to a full recovery with more promising signs to eventuate in the second half of 2003. However, the US current account deficit, which is now mostly debt financed, could engender an abrupt drop in the dollar that in turn could trigger upward pressure on interest rates and a disruption of a US recovery. Despite this, the marked decline in the exchange rate of the US dollar against the other major currencies alongside highly expansionary monetary and fiscal policies, could see the US economy grow at an above average growth rate in the next 1 to 2 years. The April 2003 IMF forecasts point to real growth in the US of 2.9 percent in fiscal year 2003/04.

The ***Australian economy*** is forecast to expand by 3.5 percent in 2003/04. It is expected that such growth will be underpinned by a recovery in exports once the drought breaks as well as improvements in the world economy. Rural export volumes are set to improve following large drought induced declines, and this will offset a slight decrease in dwelling investment caused by a fall in demand for new housing. In addition, tourism is set for a recovery as the SARS epidemic has been brought under control. Inflationary pressures are likely to be insignificant during the coming year and the Reserve Bank of Australia is likely to hold interest rates at 4.75 percent for the remainder of 2003.

Given that the disruptions associated with the SARS outbreak and the electricity crises have diminished, the ***New Zealand economy*** should regain a firmer footing in the first half of 2003-2004. However, the big picture still points to an overall easing in growth, from 4.4 percent to 2.5 percent, as the rising Kiwi dollar impacts negatively on export revenue. Despite indications that the global economy is firming, growth in NZ is expected to remain below recent highs until the export sector receives a boost from an easing NZD, firmer commodity prices and solid global growth.

The Reserve Bank of New Zealand recently adopted an easing bias and this looks set to continue if the exchange rate appreciates further and export sector activity continues to soften.

The ***Japanese economy*** has produced some positive indications of economic growth in recent months, despite persistent deflation in the economy. Eradicating deflation is still a considerable way off, requiring a step-up in demand and structural reforms, particularly a banking sector clean out. Nonetheless, economic growth is projected to pick up strength over the second half of 2003 and into 2004. Downside risks to this outlook, is a stronger yen, which could impede an export-led recovery. Overall, recovery in exports and improving business investment is expected by the IMF to lead a pick-up in GDP growth of 0.9 percent for 2003-2004.

Economic growth in the ***Euro area*** is expected to strengthen, albeit modestly by the second half of 2003 and into 2004. Household purchasing power will be supported by a reduction in the inflation rate, which the IMF forecasts will fall from 2.3 percent in 2002 to 2.0 percent in 2003 and a further 1.5 percent in 2004. The appreciation of the euro against the US dollar will exert a drag on the euro area exports throughout 2003 extending into 2004. Any further appreciation together with a prolonged weak economic growth should see the euro area interest rate cut further. The IMF forecasts growth for the euro area to be 1.7 percent for 2003-2004.

Global recovery is expected to continue for the remainder of 2003, albeit at a relatively subdued pace, as GDP growth in the major currency areas remain below potential. The US is expected to continue to lead the recovery, although GDP growth for 2003 (2.2 percent) is projected to be somewhat lower than in 2002 (2.4 percent) before advancing to 3.6 percent by the end of 2004. Macroeconomic policies around the world are expected to remain expansionary to foster growth, as many of the problems holding back global growth have receded in the last few months. On the whole, the US, Euro area and Japan - the world's three key economic engines - all face serious challenges holding the rest of the world hostage to the willingness and commitment of the authorities in those three economies to tackle their problems more vigorously.

5. THE DOMESTIC ECONOMY IN 2003/2004

The expected improvement in the world economy should have a positive impact on Samoa's exports of goods and services while the continuing low rates of inflation in NZ, Australia and the US are expected to restrain imported inflation.

Macroeconomic policies have again focused on generating real economic growth in 2003/2004. On the fiscal side, an overall Budget deficit has been approved for 2003/2004 which is slightly lower than in 2002/03. Monetary policy, which was tightened slightly in the second quarter of 2003, has again been eased to support further growth in the private sector in 2003/04.

Agricultural output is expected to improve, increasing the supply of the main stable food items to the produce markets around the country. The average prices for the main local food commodities in 2003/04 are therefore expected to either decline or not to increase much from their levels in 2002/03. Imported inflation will not be a major concern as global inflation is expected to remain low. The political crises in the Middle East seems to have intensified recently but its adverse impact on international trade, particularly in petroleum products and tourism, is not expected to be as significant as in the previous two years. But then again, by their very nature, political crises are not very predictable and anything could happen in the next twelve months. Given these factors, the annual rate of inflation is expected to hover at around 3.0 percent in 2003/2004.

On the external front, exports, tourism and private remittances are expected to improve in 2003/04. On the other hand, the expected expansion (albeit slower than last year) in aggregate demand, associated with the anticipated real growth in economic activity, is likely to strengthen the demand for imports of goods and services. As a result, the balance of payments is forecast to record an overall deficit in 2003/2004. This will reduce the level of international reserves further although it should still remain at a fairly comfortable level of above 4 months import cover.

5.1 Government Budget 2003/2004

The Government Budget for 2003/04 is expecting an overall deficit of $14.1 million (in GFS format), which is lower than the overall budget deficit for 2002/03 of $17.5 million. (See Table 3.) The projected overall budget deficit is equivalent to about 1.5 percent of nominal GDP. However, its expansionary impact on the domestic economy will be moderate given that a large part of it ($10 million) has been earmarked for the payment of Polynesian Airline's contractual obligation for returning one of its two 737 aircrafts earlier than expected.

Table 3
Financial Operations of Government
(Amounts in Tala Million)

During the period	2000/01	2001/02	2002/03 Budget	2003/04 Budget
Total Revenue and Grants	262.4	290.8	305.2	318.4
Total Revenue	197.3	198.7	231.0	251.4
Tax	174.8	182.7	206.5	224.1
Non-tax	22.5	16.0	24.5	27.3
External Grants	65.1	92.1	74.2	67.0
Total Expenditure	280.7	308.6	322.7	332.4
Current Expenditure	163.7	183.3	207.3	208.0
Development expenditure	103.1	104.2	103.8	93.5
Net Lending (1)	13.9	21.1	11.6	30.9
Overall surplus / Deficit (-)	-18.3	-17.8	-17.5	-14.1
Financing	18.3	17.8	17.5	14.1
External Financing	4.4	11.8	16.1	13.1
Disbursements	13.3	23.9	29.6	26.5
Amortisation	-8.9	-12.1	-13.5	-13.4
Domestic Financing	13.9	6.0	1.4	1.0
Monetary system	12.0	-3.5	1.4	1.0
Other	1.9	9.5	-	0

The 2003/04 budget emphasizes the renewed commitment by Government to pursuing fiscal policies that would maintain macro-economic stability. The budget strategy for 2003/04 therefore aims at maintaining a current surplus (i.e. the excess of total revenue over current expenditures in GFS format) at no less than 1 percent of nominal GDP and for the overall budget deficit (i.e. the excess of total expenditures over total revenues and grants in GFS format) to be no more that 3.5 percent of nominal GDP.

On the revenue side, there are no significant revenue raising measures introduced in the 2003/04 budget except for further refinements and broadening of the tax and non-tax base. In particular, some exemptions and loopholes have been removed and some minor duty anomalies and impacts have been resolved. Although the main aim of the revenue reform package is to restore fairness and equity, it is also designed to generate some modest additional revenue for the Budget. In the event, total revenue is targeted to increase to $251.4 million, with $224.1 million coming from tax collections, $27.3 million from non-tax collections and $67.0 million from external grants.

On the expenditure side, the Budget reflects Government's commitment to enhancing opportunities in health and education services, agriculture development, infrastructure, small business development and a range of community services. The Budget reaffirms Government's commitment to the promotion of the tourism industry, a major sector in the economy. Apart from the services component of expenditures in the priority sectors, the construction of buildings and similar facilities will contribute further to growth in that particular sector. In the education sector, Government's program for the construction of school buildings around the country continues in 2003/04. In the agriculture sector, some key initiatives included in the 2003/04 budget should see the output of the sector improve in the years to come. These include the construction of a National Abattoir, which will improve the export potential of locally produced meat products, the import of tropical sheep to be trialed in Samoa for local consumption, the continuation of the copra subsidization program and the revitalization of the cocoa industry. On the infrastructure sector, investment in the provision of electricity, good quality water and roads and bridges throughout the country will continue. On tourism, a substantial Government investment in the national carrier Polynesian Airlines and support for an up market resort at the Faleolo International Airport area will assist in developing this important industry further. For the 2007 South Pacific Games that will be hosted by Samoa, the 2003/04 budget has provided for the preparatory and design costs of the facilities for the games. No major construction work is scheduled to begin in 2003/04 except for the office of the South Pacific Games Authority and the construction of sports fields.

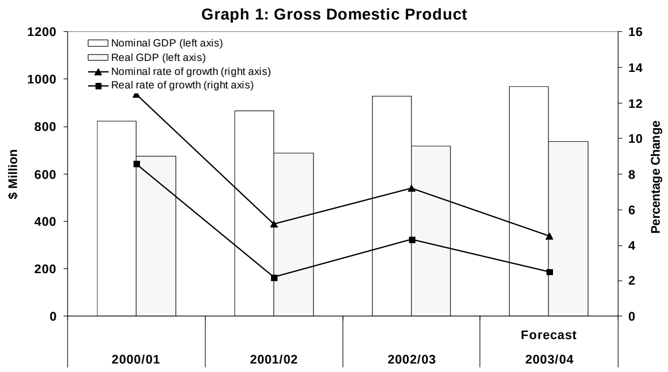
Total expenditures for the 2003/04 financial year therefore amounts to $332.4 million, consisting of $208.0 million for current expenditure, $93.5 million for development expenditure and $30.9 million in net lending to government corporations and public enterprises.

For 2003/04, therefore, the current surplus amounts to $43.3 million (around 4.5 percent of GDP) and the overall budget deficit amounts to $14.1 million (1.5 percent of GDP). The overall budget deficit will be financed almost entirely by external borrowing ($13.0 million), with a $1.0 million borrowing from domestic sources. The overall budget deficit will therefore not have a significant adverse impact on the financial resources available for private sector development. If anything, it will inject new money into the economy.

5.2 Real Sector Outlook

The economy looks set to expand further in 2003/04, supported by the continuation of expansionary macro-economic policies. Growth, however, is not expected to be as strong as in 2002/03. On one hand, the positive contribution to growth of the overall budget deficit will be lessened by the outflow of funds overseas to meet Polynesian Airline's contractual obligation associated with the return of one of its aircrafts. And, the other, the implementation of a number of substantial private sector construction projects is expected to spill over to the following financial years.

Apart from a few public sector projects that will be implemented under the Government Budget for 2003/04, some large private sector projects are set to begin in 2003/04. These include the SamoaTel project at Maluafou, the Aggie Grey's Airport Resort at Faleolo, the Chinese funded aquatic center at Tuanaimato and the rebuilding of the Church of Jesus Christ Latter Day Saints (LDS) Temple at Pesega. Growth will also be boosted by the expected recovery in exports and tourism, the continued inflow of private remittances and the expected growth in private sector credit. The SamoaTel project is already underway while the rest are still being designed. All in all, real GDP growth is expected at between 2 and 3 percent in 2003/04. (See Graph 1.)



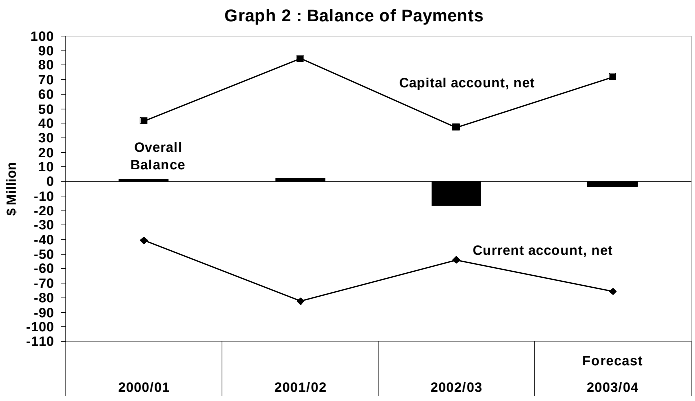
5.3 Balance of Payments Outlook

The balance of payments is projected to record a moderate overall deficit in 2003/04 due mainly to the expected recovery in the demand for imports from a very low level in 2002/03. (See Table 4 and Graph 2.) The strong import growth is expected to come from the anticipated growth in bank credit to the private sector, the improvement in exports, tourism and private remittances as well as the implementation of the major construction projects mentioned above.

Table 4
Balance of Payments
(Amounts in Tala million)

During the period	2000/01	2001/02	2002/03	2003/2004 Forecast
A. Current Account Balance	-40.3	-82.3	-53.8	-75.7
Merchandise Trade Balance	-363.1	-415.4	-382.3	-420.4
Exports	49.9	49.7	41.3	45.6
Imports	-412.9	-465.0	-423.7	-466.0
Services & income, net	169.0	157.5	152.5	159.1
Travel, net	135.0	137.6	144.6	150.2
Investment income, net	1.4	-1.2	-12.5	-12.7
Other services, net	32.6	21.1	20.4	21.6
Private remittances, net (1)	153.8	175.5	176.0	185.6
B. Capital Account Balance	41.7	84.6	37.1	72.2
Official grants, net	71.3	77.0	74.2	67.0
Official Loans, net	17.6	11.6	4.7	13.2
Government guaranteed loans, net	-10.0	-8.9	-7.3	-7.9
Private capital, net (2)	-37.3	4.9	-34.5	-
C. Overall Balance	1.4	2.3	-16.7	-3.4

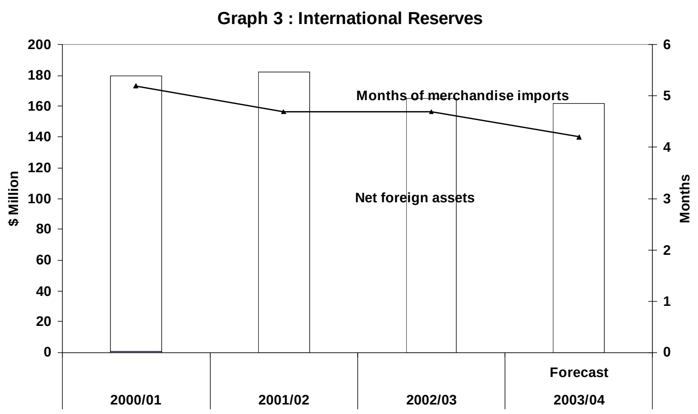
Source: Central Bank of Samoa
(1) Unrequited transfers.
(2) Includes errors and omissions.



Exports are expected to improve by about 10 percent in 2003/04, largely as a result of the anticipated recovery in the exports of fish as well as the expected increases in exports of garments, beer, nonu products, coconut cream and desiccated coconut. With the anticipated recovery in the US, the export price for fish is expected to improve slightly in 2003/04. This, together with the launching of a number of key Government policy amendments related to the fishing industry should encourage more fishing boats which were anchored idle in 2002/03 to take to the sea again, intensifying the fishing effort in 2003/04. Revenues from fish are therefore expected to improve by about 12 percent in 2003/04. Significant demand for garments from Europe became evident in 2002/03 and further growth to that region is again expected in 2003/04 so that export earnings from this product are anticipated to improve. Beer exports performed remarkably well in recent years as the beer manufacturer focuses more and more on overseas markets to compliment the limited size of the domestic market. An improvement in the American Samoan economy, the main export market, and increased exports to neighboring islands should see further growth in beer exports in 2003/04. Improved US and Japanese economies are expected to improve the prospects for exports of nonu products to these two countries and coconut cream is expected to hold up well with the anticipated steady growth of the New Zealand and Australian economies. Desiccated coconut is expected to grow further this financial year following the installation of new quality control machinery at the factory.

Tourism is expected to recover from the lows of the past two financial years. The global outlook for tourism has started to improve but there are still concerns about safety in the light of recent terrorist attacks in the Middle East and Asia. The expected improvement in the world economy and the relative isolation of the Pacific region from the rest of the world should attract more tourists to Samoa in the coming months. Furthermore, the reopening of the Sinalei Reef Resort located to the south of Upolu in September 2003 has increased accommodation and recreational facilities for tourists in 2003/04. Earnings from tourism are therefore expected to improve in 2003/04. Foreign exchange revenues from Yasaki operations are expected to remain strong, in line with the continued steady economic performance of its main market – Australia. The inflow of private remittances is also expected to grow with the steady economic performances of the main source countries - New Zealand and Australia – as well as the anticipated recovery in the US economy. The rebuilding of the LDS Temple at Pesega is also expected to boost the inflow of private remittances in 2003/04 and the following year.

On the capital account, the Government Budget projects a large (threefold) increase in the net inflow of Government loans disbursements, partly offset by a 10 percent reduction in the net inflow of external grants in 2003/04. In the event, the balance of payments is expected to close the financial year 2003/04 with an overall deficit of $3.4 million. With imports poised to expand, net foreign assets are therefore expected to fall to a level equivalent to 4.2 months of imports of goods at the end of June 2004 from 4.7 months at the end of June 2003. (See Graph 3.)

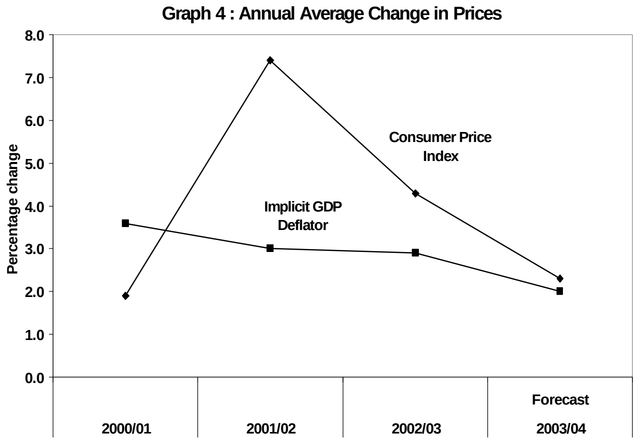


5.4 Inflation Outlook

With real GDP growth expected to slow down in 2003/04, demand pressures are also anticipated to ease. As a result, the annual rate of inflation is expected to decline.

For 2003/2004, agricultural supplies are projected to improve, easing pressure on local food prices. The upward pressure on prices is expected to come mainly from increased prices of building and construction materials as construction activities associated with the start of the major projects mentioned earlier intensify, the recently increased water rate (effective July 2003) and further rises in the prices for beer and cigarettes that took effect on August 1, 2003. Thus, the current slowdown in the rate of growth of the local component of the CPI is expected to continue into 2003/04, falling further to 2.4 percent on an annual average basis. The import component, on the other hand, is forecast to increase 2.1 percent, in line with the expected world inflation rate. Despite the recent spate of terrorist attacks around the globe and the continuing fragile situation in Iraq (the second largest oil producer in the world), the supply and prices of petroleum products are not expected to change dramatically in 2003/04.

Overall, therefore, the annual rate of inflation is expected to decline to 2.3 percent in the twelve months to end June 2004 from 4.3 percent in the same period last year. (See Graph 4.)



6. MONETARY POLICY STANCE FOR 2003/2004

The latest figures and Bank estimates suggest that the economy grew by a remarkable 4.3 percent in real terms in 2002/2003 while the annual rate of inflation, which accelerated to 8.3 percent in November 2002, eventually slowed down to 4.3 percent at the end of June 2003 (compared to 7.4 percent at end June 2002). The level of international reserves, as measured by the ratio of net foreign assets to imports, was maintained at the same level as in 2001/02 of 4.7 months.

The Bank's forecasts for 2003/2004 show a stable macro-economic picture, amid the slow recovery in the world economy. Real GDP is expected to grow further in 2003/04, albeit at a slower pace than in 2002/03, and the annual inflation rate is projected to stay below the long-term target rate of 3.0 percent. And, although the level of reserves is expected to decline, our forecasts show that it should still remain above our long-term target level of 4.0 months imports of goods.

In March 2003, the updated macro-economic forecasts for 2002/03 pointed to a need to tighten monetary policy to minimise the potential adverse impact of the Polynesian Airlines, Aggie Grey's Faleolo Airport Resort, SamoaTel and Development Bank projects on international reserves and inflation. As a precautionary measure, therefore, monetary policy was tightened slightly in the second quarter of 2003 pending the outcome of ongoing discussions on these projects as well as the 2003/04 Government Budget. This entailed raising the Bank's benchmark interest rate and the issuance of CBS securities with longer-term maturities.

Much has now become known about those projects as well as the shape of the Government Budget for 2003/04 and other macro-economic variables. Government has been able to slightly reduce the size of its overall budget deficit in 2003/04 and the Development Bank building has been postponed for reconsideration in the next financial year.

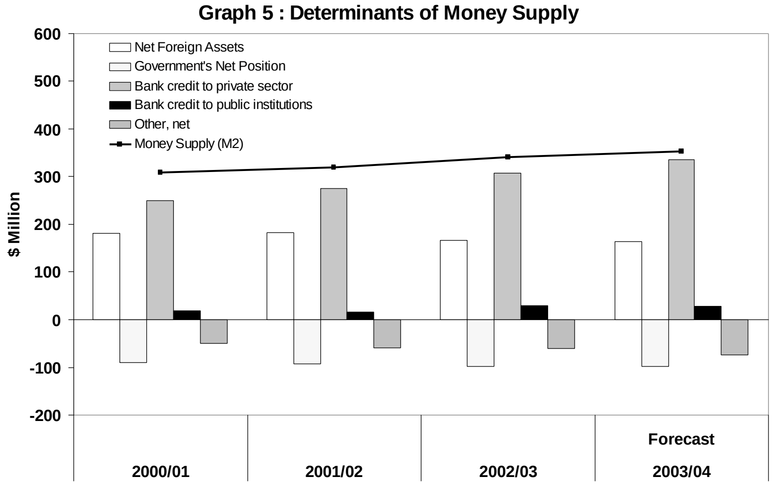
Based on the Bank's forecasts, the macro-economic outlook for 2003/04 remains steady with inflation no longer considered a major concern and international reserves expected to be maintained at above the minimum required level. Monetary policy in 2003/04 will therefore focus on providing support for sustaining real economic growth with the Bank adopting a slight easing in its monetary policy stance. In the event, private sector credit is projected to expand 9.3 percent in the year to end June 2004 and money supply (M2) is expected to grow 3.7 percent. (See Table 5 and Graph 5.)

Table 5
Monetary Survey
(Amounts in Tala million)

End of Period	2000/01	2001/02	2002/03	2003/04 Forecast
A. Determinants of Money Supply				
Net Foreign Assets	179.9	182.2	165.5	162.0
Net Domestic Assets	128.3	137.0	175.0	191.0
Government's Net Position	-89.5	-93.0	-99.2	-98.2
Bank credit to private sector	249.9	274.7	306.1	334.5
Bank credit to public institutions	17.8	15.2	30.2	28.3
Others, net	-49.9	-59.9	-62.1	-73.6
B. Money Supply (M2)	308.3	319.3	340.4	353.0
Narrow Money	88.7	92.3	93.8	99.3
Currency Outside banks	23.3	26.1	26.2	27.6
Demand Deposits	65.3	66.2	67.6	71.7
Quasi-money	219.6	227.0	246.6	253.8
Savings deposits	40.4	45.5	45.5	50.0
Time deposits	156.6	171.4	184.8	190.5
Foreign Currency Deposits of Residents	22.7	10.1	16.3	13.2

Source: Central Bank of Samoa

Graph 5 : Determinants of Money Supply



6.1 Open Market Operations and Interest Rates

The above monetary policy stance was adopted by the Bank's Board at its Meeting in August 2003. This resulted in the Bank reducing its benchmark 91-days interest rate (from 5.4 percent to 5.0 percent), and reintroduced the issue of shorter-term Central Bank Securities.

The Central Bank implements monetary policy by conducting open market type operations by auctioning Central Bank Securities (its main monetary instrument) to influence liquidity and monetary conditions in the banking system.

On a monthly basis, the Research & Statistics Department and the Financial Markets Department meet to discuss and determine the appropriate amount of liquidity to target and the corresponding amount of securities to be issued. For any month, the targeted level of liquidity is always consistent with the Central Banks stance on monetary policy.

At the end of every week, a liquidity forecast is carried out by the Financial Markets Department. In the event that the forecast highlights a situation where total commercial bank deposits with the Central Bank exceeds the targeted amount of liquidity, securities would be issued. On the other hand, if total bank deposits fell short of the target, no securities would be issued.

At the end of June 2003, interest rates on all Central Bank Securities (14 days, 28 days, 56 days, 91 days, 182 days and 365 days) declined when compared to June 2002. The recorded falls in yields, were significant at the short end, while at the long end, the falls were minor.

In April this year, the Central Bank received technical assistance from the International Monetary Fund to develop and implement a repurchase facility. This facility has been implemented and will provide commercial banks, which are short of liquidity, with the necessary short-term funds. The repurchase facility has increased the number of tools which the Central bank can use to influence the amount of liquidity in the monetary system.

6.2 Exchange Rate Policy

The main objective of the Central Bank's exchange rate policy is to maintain the competitiveness of local export industries in the international market whilst minimizing imported inflation.

In the year to end June 2003, the real effective exchange rate index fell 1.25 percent. This movement was mainly attributed to the depreciation of the currency in nominal terms as compared to the currencies of our major trading partners.

The Bank intends to maintain the overall real value of the Tala at a competitive level. The exchange rate setting will be adjusted accordingly to ensure that local industries remain competitive and inflation is kept in check.

6.3 Foreign Exchange Regulations

No changes were made to foreign exchange regulations in 2002/2003. However, in 2003/04, some amendments are being considered. Local borrowing for the purchase of fishing boats that would be operating primarily in other fishing zones and exporting directly from there without the proceeds coming back to Samoa will be reviewed. Such borrowing absorbs funds that could have been lent to other activities that bring foreign exchange to Samoa.

In addition, the Bank will also be reviewing the authorities delegated to the commercial banks and foreign exchange dealers so as to minimise the large unscheduled outflows of foreign exchange reserves.
