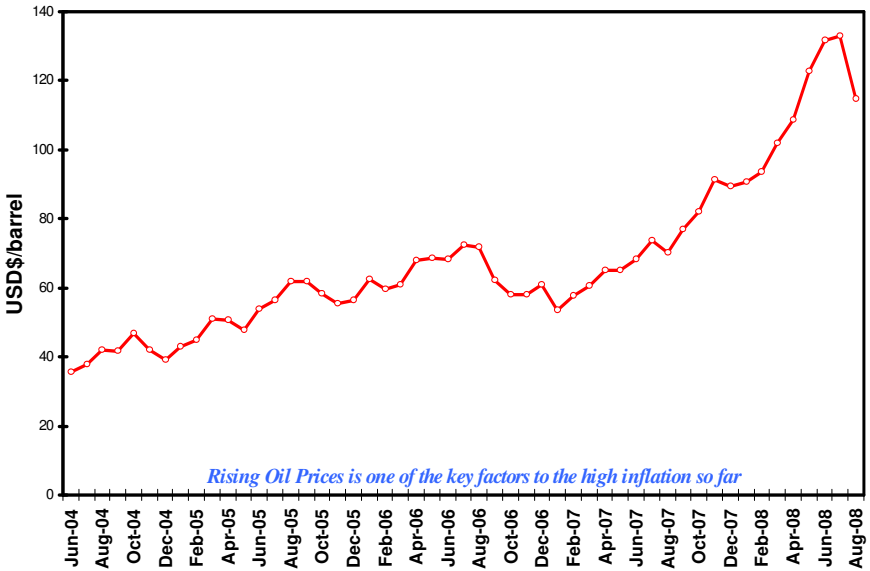




CENTRAL BANK OF SAMOA

International Crude Oil Prices



MONETARY POLICY STATEMENT FOR THE FINANCIAL YEAR 2008/2009

APIA
September 2008

CONTENTS

Page

1.	INTRODUCTION.....	1
2.	EXECUTIVE SUMMARY.....	2
3.	WORLD ECONOMY.....	5
4.	DOMESTIC ECONOMY IN 2007/2008.....	8
	4.1	Policy Developments
	4.2	Macro Economic Performance
	<i>4.2.1</i>	<i>Real Sector</i>
	<i>4.2.2</i>	<i>Balance of Payments</i>
	<i>4.2.3</i>	<i>Prices</i>
5.	DOMESTIC ECONOMIC OUTLOOK FOR 2008/2009.....	22
	5.1	Government Budget
	5.2	Real Sector
	5.3	Balance of Payments
	5.4	Prices
	<i>5.4.1</i>	<i>Headline Inflation</i>
		<i>Import Component</i>
		<i>Local Component</i>
		<i>Headline Inflation Rate</i>
	<i>5.4.2</i>	<i>Underlying inflation</i>
		<i>Import Component</i>
		<i>Local Component</i>
		<i>Underlying Inflation Rate</i>
6.	MONETARY POLICY STANCE FOR 2008/2009.....	27

1. INTRODUCTION

In line with Government's emphasis on transparency and accountability, Monetary Policy Statements (MPS) serve as the main vehicle to communicate and promote public awareness of the main objectives of monetary policy and the targets that would be pursued by the Central Bank in the year ahead. As well, these Statements are issued in accordance with the Central Bank's Corporate Plan and the latest of Government's Strategy For The Development of Samoa. The main objective of the Central Bank's monetary policy is to promote sustainable real economic growth by maintaining price stability and international reserves viability. In order to achieve these objectives, monetary policy decisions are conducted via open market operations through the issuance and trading of Central Bank Securities.

In pursuing the goal of price stability, the Central Bank relates Samoa's inflation rate to those of its major trading partners. The annual inflation rates for Samoa's main trading partners currently 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 that the changes in prices are beyond the realms of monetary policy and the control of the Central Bank. The experience of recent years particularly in the last half of 2007/08 bared witness to this situation when the persistently sharp and new heights of international prices for crude oil and food exerted significant pressures on the domestic prices of petroleum and food items. During such periods, attention is focused more on the underlying or core inflation rate.

Samoa is a small open economy with total merchandise trade alone representing around 60 percent of nominal GDP. It is crucial therefore that Samoa maintains a sufficient level of international reserves to withstand unforeseeable economic shocks. Under present circumstances, the Central Bank considers a level of gross official international reserves,

equivalent to no less than 4.0 months of imports of goods, as adequate for maintaining the country's long term international viability.

On the exchange rate, the main objective of the Central Bank's policy is to ensure that export-oriented industries remain competitive in overseas markets whilst at the same time minimizing imported inflation. While there is no specific target level for the nominal effective exchange rate (NEER) of the Tala, the Central Bank aims to avoid a substantial real appreciation of the Tala since it can adversely affect the international competitiveness of the export sector.

2. EXECUTIVE SUMMARY

After strong global expansion in the past five years, the world economy slowed down to post a 4.5 percent real growth rate in 2007/08. World inflation, on the other hand, started to gather momentum, rising to 2.8 percent from 2.0 percent in the preceding fiscal year. While economic growth was noted around the globe, monetary policy settings were generally mixed as the authorities tried to strike a balance between growth and the looming inflationary pressures. In the US, the Federal funds rate was aggressively cut while the Euro area and Japan have decided to hold policy rates steady.

In 2008/09, global expansion is expected to lose speed further to 4.0 percent while inflation is anticipated to hold at 2.8 percent. Growth is expected to be led by the Emerging markets and Developing countries, particularly China and India, with lower contributions from the US, Eurozone and Japan. The New Zealand and Australian economies are expected to moderate in 2008/09 as inflationary expectations continue to rise.

In Samoa, the Central Bank's tightened monetary policy stance combined with a large net inflow of foreign funds to drive up commercial bank liquidity to a more healthy position in 2007/08. The Statutory Reserve Deposit ratio (SRD) which was reduced to 3.5 percent in October 2006 was therefore reverted back to 4.5 percent in March 2008. The amount of Central Bank securities issued consequently surged, slightly reducing the weighted average official rate and the commercial bank interest rates over the year. Despite this slip in interest rates, the annual average growth in private sector credit and money supply (M2) notably declined.

The available estimates showed that the Samoan economy grew by a further 3.9 percent in real terms in 2007/08, driven by

all sectors except for the “food and beverages manufacturing” and the “construction” sectors. This growth was largely boosted by the South Pacific Games in the first half of the fiscal year under review. The external sector, likewise, posted a favourable outcome, with the balance of payments recording a substantial overall surplus, driving up the level of international reserves to a comfortable 5.1 months of import coverage.

Inflation, on the other hand, remained a concern in 2007/08 as the domestic impact of high international prices of oil and food combined with strong aggregate demand to push both the headline and the underlying inflation rates higher to levels well above the long term annual target of 3.0 percent.

For the fiscal year 2008/09, the economy is expected to remain on a solid footing, with a further 3 percent growth rate. This expansion will be driven mostly by the continuation of infrastructural road works and sanitation projects as well as the refurbishment and strengthening of the priority sectors such as the Education, Health and the Agriculture sectors. Similarly, the balance of payments is anticipated to register another large overall surplus of around \$44 million. The major contributing factors would be the expected large disbursement of Government loans, increased project grants and further growths in tourism earnings and private remittances.

Inflation is expected to remain high in 2008/09, with the annual headline inflation rate likely to accelerate to 7.0 percent at end June 2009 from 6.2 percent at end June 2008. The annual underlying inflation rate, on the other hand, is anticipated to fluctuate during the year before easing down to 6.7 percent at end June 2009 from 6.9 percent at end June 2008.

Given that both measures of inflation will be dominated by the movement in imported inflation, stronger private sector growth and development to increase domestic production is crucial. Therefore, to support private sector growth, monetary policy has been relaxed in 2008/09. This easing of monetary policy

would see the growth in private sector credit and total money (M2) rise to 12 percent and 11 percent respectively, with the former almost doubled the level in 2007/08. (See Table 1.)

Table 1
Selected Domestic Economic Indicators

Fiscal year to end June	2004/05	2005/06	2006/07	2007/08	2008/09 Forecast
	(Percentage change over the previous year)				
Real sector					
Nominal GDP	10.6	8.3	10.1	8.1	10.5
Real GDP	5.7	1.4	4.7	3.9	3.0
Prices					
Headline Consumer Price Index (annual average)	7.8	3.2	4.9	6.2	7.0
Underlying Consumer Price Index (annual average)		2.2	5.6	6.9	6.7
Implicit GDP Deflator (annual average)	4.6	6.7	5.1	4.0	7.3
Monetary aggregates					
Net foreign assets (annual average)	12.5	-2.3	-3.6	9.5	13.8
Government's net monetary position (end of period)	22.9	-10.9	12.7	-11.9	7.6
Bank credit to private sector					
Annual average	12.1	21.3	21.6	6.1	11.7
End period	6.8	28.2	11.7	6.5	11.6
Money Supply, M2					
Annual average	10.8	14.0	13.1	11.2	10.5
End period	15.0	13.0	8.7	12.1	12.2
Exchange rate					
Nominal Exchange Rate	0.48	0.11	0.76	0.16	na
Real Exchange Rate	5.72	-1.49	2.49	4.54	na
International reserves					
Gross International Official Reserves (Tala million)	228.27	179.08	207.54	254.6	298.06
Gross International Official Reserves (Months of imports)	5.9	3.9	4.0	5.1	5.5
Weighted average interest rates					
	(End of period, percent pa.)				
CBS 14 days Securities	2.22	-	4.30	4.08	3.93 (1)
CBS 28 days Securities	3.20	-	5.65	4.04	3.71 (1)
CBS 56 days Securities	4.23	-	6.00	5.35	3.80 (1)
CBS 91 days Securities	4.92	-	6.00	5.38	4.90 (1)
CBS 182 days Securities	-	-	-	-	
CBS 365 days Securities	-	-	-	-	
CBS Securities overall weighted average yield (annual average)	3.5	1.9	5.3	4.7	4.7 (1)
Commercial bank deposits	4.3	4.8	6.5	6.2	5.9 (1)
Commercial bank credit	11.0	11.5	12.8	12.7	12.6 (1)
Commercial bank interest rate spread	6.7	6.7	6.2	6.6	6.7 (1)
Source: Central Bank of Samoa					
(1) Interest rate as at end August 2008					
na - not available					

3. WORLD ECONOMY

Global economic expansion started to lose momentum towards the end of 2007/08 while inflation picked up quickly. But, despite the financial crisis (prompted by the US subprime collapse) that shocked the world economy in 2007/08, the world economy still managed to grind out a sound 4.5 percent rate of growth with a 2.8 percent inflation rate. (See Table 2.)

Fiscal year to end June	2005/06	2006/07	2007/08	2008/09 Forecast	
Real growth rate	4.9	5.5	4.5	4.0	
Inflation rate	2.3	2.0	2.8	2.8	
Official international interest rates,	(End of period, percent p.a)				
US Federal Reserve	5.25	5.25	2.00	2.00	(1)
Reserve Bank of Australia	5.75	6.25	7.00	5.75	(2)
Reserve Bank of New Zealand	7.25	8.01	7.50	7.00	(3)
Bank of Japan	0.10	0.50	0.50	0.50	(4)
Bank of England	4.50	5.50	5.00	5.00	(5)
European Central Bank	2.75	4.00	4.25	3.75	(5)
Reserve Bank of Fiji Notes, 91 days	2.25	4.25	n/a	n/a	(6)
Source: IMF and reserve banks' publications and information releases.					
(1) Interest rate as at 16th September 2008.					
(2) Interest rate as at 2nd September 2008.					
(3) Interest rate as at 11th September 2008.					
(4) Interest rate as at 18th September 2008.					
(5) Interest rate as at 4th September 2008.					
(6) RBF Note issuance has been suspended until further notice.					

While economic growth was noted around the world, monetary policy settings were generally mixed. In the US, the Fed funds rate was aggressively cut as the Fed focused on combating the financial strains brought on by the US sub-prime crash. The Euro area and Japan, on the other hand, held their policy rates steady. Going forward, monetary policy settings are expected to continue down this path. The Fed has clearly signaled rates to move up in its bid to contain a growing inflation problem, while the Euro area and Japan will continue to hold rates

steady as both struggle to strike a balance between inciting growth and fighting inflationary pressures.

On the exchange rate front, the US dollar was generally weak against the other major currencies, consequent to a beleaguered US economy and poor interest rate differentials. The situation for the US dollar is expected to continue in 2008/09 as the US economy continues to fight to lift itself out of economic gloom.

The latest IMF update of World Economic Outlook (WEO) in July 2008 forecasts growth to decelerate to 4.0 percent in 2008/09. Inflation, on the other hand, is expected to hold at 2.8 percent for the same period. China and India are again projected to lead economic growth with growth rates of 9.7 percent and 8.0 percent respectively for 2008/09, while the US, Eurozone and Japan growth rates are forecasted at 1.1 percent for the US and 1.5 percent each for the Euro area and Japan.

While the global expansion is losing speed, inflationary pressures are quickly mounting boosted by rising energy, food and commodity prices. Policymakers are thus faced with the difficult task of heading off rising inflationary pressures while keeping sight of risks to growth. This is the ultimate challenge to the global growth outlook together with financial market turbulence yet to peter out.

Oil and food prices are expected to remain high and volatile, with moderate declines expected later in the year. Supply concerns and inelastic demand for oil continue to drive up oil prices which reached a peak of US\$147 per barrel in July 2008. Oil prices have since come off these record levels but are forecast to remain high for the rest of the year. Food prices, however, have been driven by poor weather conditions coupled with continued strong demand, particularly for biofuels. Commodity prices are at the mercy of breakneck growth from the Emerging and Developing economies (China and India)

and for the foreseeable future, they are expected to remain high.

New Zealand

The New Zealand economy recorded another prosperous year of 3.0 percent real growth in 2007. However, after a decade of largely uninterrupted growth, the New Zealand economy finally looks set to be entering a period of rebalancing and consolidation. Economic activity contracted by 0.3 percent over the first three months of 2008, taking year on year growth to 1.9 percent. Indicators for the June quarter look no better and in fact suggest activity could possibly be weaker than in the March 2008 quarter.

Sales of big ticket items such as motor vehicles, appliances and furniture are heading backwards, employment is falling, business and consumer confidence have tumbled and financial conditions remain tight. Other headwinds facing the economy are: domestic petrol prices at record high levels, food prices rising strongly and mortgage rates remaining elevated. These have come at a time when the economy is already vulnerable with a high current account deficit, weak household savings, high indebtedness, poor productivity growth, capacity constraints and domestic inflationary pressures.

With economic activity looking more likely to be subdued in the coming quarters, the Reserve Bank of New Zealand (RBNZ) has signalled its willingness to start easing monetary policy, which it has begun at its July policy review with a 25bps cuts to the OCR to 8.0 percent. More cuts are expected before the end of 2008. Economic activity will be hit hard as spending notably for residential investment and consumption remain weak. Employment intentions are also falling and are expected to result in further softness in the labour market.

Positive factors to support the economy are strong commodity prices, fiscal stimulus (large pending infrastructure projects and

personal income tax cuts) and looser monetary conditions. Overall, growth for 2008/09 is projected at 2.0 percent with an inflation forecast of 3.1 percent.

On the currency front, the New Zealand dollar is expected to decline in anticipation of a weaker economy and lower interest rates.

Australia

The Australian economy grew 3.9 percent in 2007. Since then, there has been little doubt the Australian economy is slowing, with only 0.6 percent growth noted in the March 2008 quarter and 0.3 percent growth in the June 2008 quarter, taking growth for 2007/08 to 2.7 percent. Domestic demand is softening under the weight of high interest rates and high oil prices. Business credit has slowed dramatically, the housing market has cooled, consumer confidence has plummeted and employment growth is slowing. Further complicating the Reserve Bank of Australia's (RBA) job, inflation is lingering near 4.0 percent and inflationary expectations are rising.

The RBA has signalled its comfort with the current slowdown and therefore possible moves in the cash rate would be downward. But the dilemma remains that while domestic demand is slowing, income tax cuts and commodity price windfalls means that the risk of a reacceleration in growth, particularly if petrol prices and financial markets stabilise, is significant. Given the inflation backdrop, the RBA will have little tolerance for signs of a rebound in spending.

While household disposable income growth will slow due to record oil and food prices, favourable labour market conditions and income tax cuts should help to soften the blow from recent interest rate rises. The resources sector continues to support the economy and business investment, net-exports and income from the terms of trade effect look like cushioning the

headwinds to the economy. Growth for 2008/09 is forecast at 2.3 percent with an inflation outlook of 3.8 percent.

The Australian dollar is projected to decline slightly from its current highs with the anticipation of a looser monetary policy but support would be found in solid commodity prices.

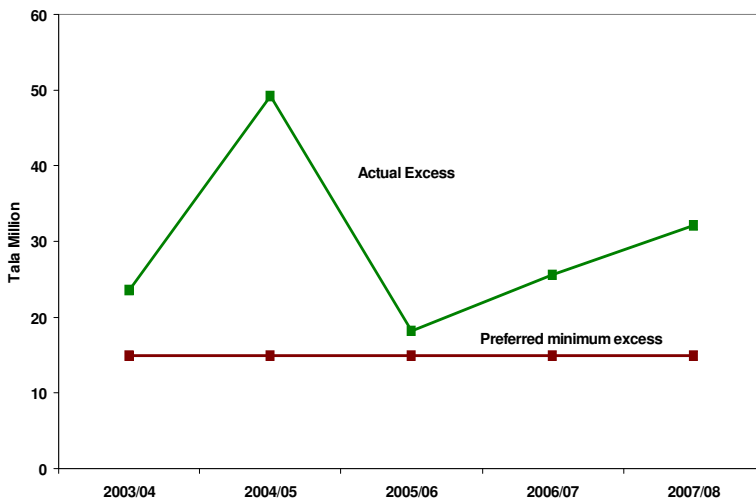
4. DOMESTIC ECONOMY

4.1 Policy Developments

Government continued with its expansionary fiscal stance in 2007/08 to ensure memorable success in hosting the 13th South Pacific Games in August/September 2007. The approved 2007/08 Budget therefore resulted in a Budget Deficit of \$14 million, which is equivalent to 1.1 percent of the nominal GDP. The overall deficit was largely financed by external borrowings.

To alleviate Government induced pressures on inflation as well as to assist the recovery path of liquidity, monetary policy remained tightened throughout 2007/08. As expected, bank credit to the private sector and the growth in total money supply (M2) declined notably during the year.

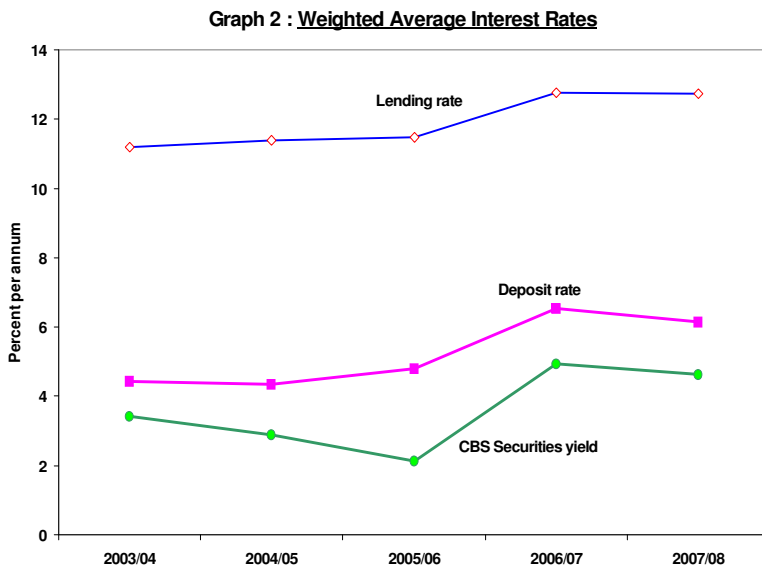
This tightened stance of monetary policy combined with a strong net inflow of funds from abroad, pushed commercial bank liquidity up to a more comfortable position. From an average monthly level of \$35.1 million in 2006/07, commercial bank liquidity almost doubled to reach an average monthly level of \$67.5 million in 2007/08. Excess reserves, in particular surged to an average of \$27.7 million per month, a level that was well above the preferred minimum level of \$15 million. (See Graph 1.)

Graph 1 : Commercial Banks' Excess Liquidity

With the continued build-up of liquidity to comfortably healthy levels, especially in the first half of 2007/08, the Statutory Reserve Deposit Ratio (SRD) which was lowered in October 2006 to 3.5 percent was restored to 4.5 percent in March 2008.

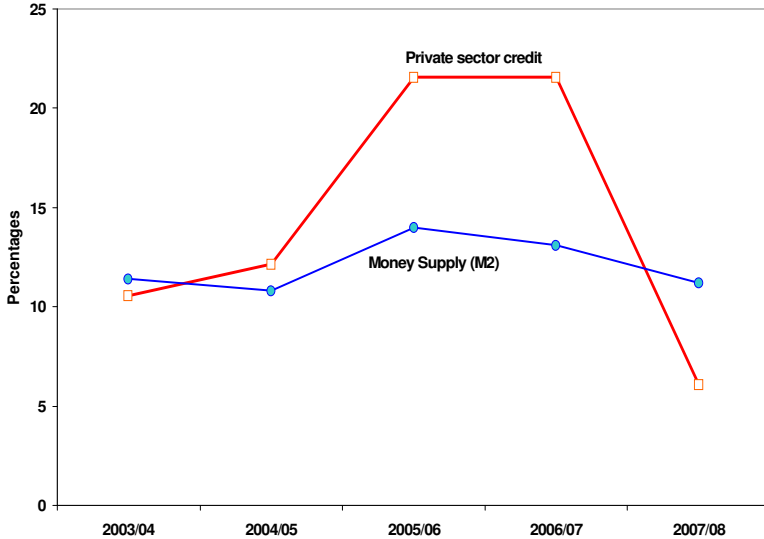
The healthy liquidity position of commercial banks saw a substantial increase in the amount of securities issued, particularly in the second half of 2007/08, with auctions for the 91 day security resuming in January 2008. At end June 2008, total securities outstanding amounted to \$45.0 million, of which \$23.5 million were for short term bills and \$21.5 million were for the 91 day security. In contrast, at end June 2007, there were only \$11.5 million outstanding securities of which \$10.5 million were for short term securities and only \$1 million were for 91 days. With the demand for securities increasing, the weighted average yield on Central Bank securities declined to 4.62 percent at end June 2008 from 4.94 percent at end June 2007. Following the downward trend in official rates, commercial bank interest rates fell with the weighted average lending and deposit rates both slipping to 12.74 percent and 6.15 percent

respectively from 12.76 percent and 6.54 percent in the same period. (See Graph 2.)



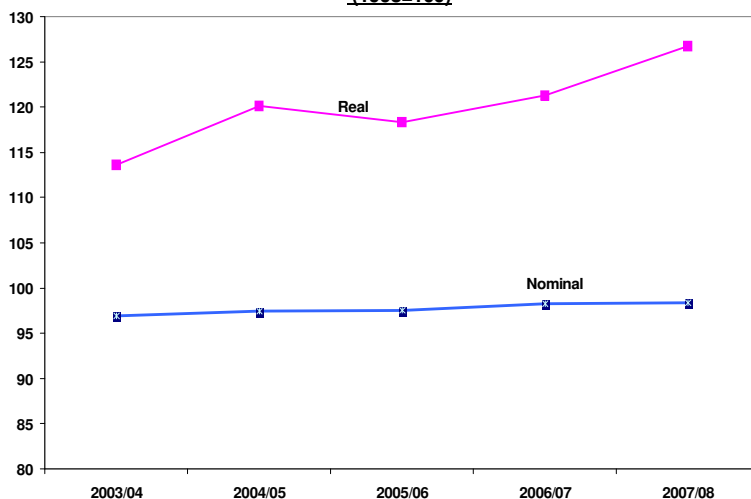
Also driving the marginal decline in interest rates, the growth in bank credit to the private sector slowed down significantly in 2007/08. On an annual average basis, the growth in private sector credit decelerated to 6.1 percent from 21.6 percent in 2006/07. As a result, the annual growth of total money supply (M2) also slowed down to 11.2 percent from 13.1 percent in the previous fiscal year. (See Graph 3.)

Graph 3 : Annual Average Growth Rates



In 2007/08, the nominal effective exchange rate (NEER) of the Tala appreciated 0.16 percent on an annual average basis against the currencies in its exchange rate basket. It also appreciated in real effective terms (REER) by a larger 4.54 percent reflecting the higher inflation rate in Samoa compared to those of our major trading partners. (See Graph 4.)

Graph 4 : Trade Weighted Exchange Rate Indices
(1998=100)



4.2 Macro-economic performance

4.2.1 *Real Sector*

National account figures for the June 2008 quarter are not yet available but estimates indicate that the economy grew further in real terms by 3.9 percent in 2007/08, albeit slower than the 4.7 percent growth in 2006/07. Except for the “food and beverages manufacturing” and the “construction” sectors, all sectors posted significant growths led by the “hotels and restaurants”, “fishing”, “other manufacturing” and “agriculture” sectors. This growth in 2007/08 reflected the significant impact of the South Pacific Games in the first half of the financial year under review.

Table 3
Real Gross Domestic Product by Industry

(At 2002 prices, amounts in Tala Million)

During the period	2004/05	2005/06	2006/07	2007/08	2008/09
				Updated	Forecast
Agriculture	70.8	71.3	69.6	74.7	76.7
Fishing	51.0	47.2	51.3	56.7	56.3
Food & Beverage manufacturing	32.6	32.6	28.6	26.2	26.4
Other Manufacturing	105.3	89.4	98.2	106.2	105.7
Construction	79.2	86.3	98.1	98.0	100.9
Electricity and water	43.7	45.6	47.0	48.5	49.9
Commerce	188.4	196.7	206.1	211.6	223.2
Hotels, restaurants	26.1	30.5	33.2	39.1	40.5
Transport, Communication	126.0	128.5	134.6	139.3	143.1
Public administration	80.4	81.6	82.8	85.4	89.3
Finance and business service	92.8	96.4	100.2	102.8	106.9
Less: Enterprise share of FISIM (1)	-11.9	-12.2	-12.5	-12.8	-13.1
Ownership of dwellings	34.9	35.6	36.3	37.1	37.8
Personal and other service	59.6	63.4	66.5	68.2	69.5
Total	978.9	992.8	1039.8	1080.9	1113.0
Annual percent change	5.7	1.4	4.7	3.9	3.0
Implicit GDP deflator	112.5	120.1	126.2	131.3	140.9
Annual percent change	4.6	6.7	5.1	4.0	7.3

Source: Ministry of Finance

(1) FISIM : Financial Intermediary Services Imputed

Following modest growths in recent years, the “hotels and restaurant” industry grew exceptionally strong in 2007/08, particularly in the first half of the fiscal year. Boosted by hosting the best ever South Pacific Games in August/September 2007, the “hotels and restaurants” sector registered the largest growth of 26.2 percent in the first half of 2007/08 and 17.7 percent for the year as a whole. The “fishing” industry continued to recover in 2007/08, posting notably a 10.5 percent increase in real output, as the catch per unit effort (c.p.u.e) for long line fishery increased due to favourable oceanic conditions that result in high productivity and the availability of tuna species in the Exclusive Economic Zone of Samoa. Assisted by the strengthened Australian dollar, earnings from the export of automotive wire harnesses to Australia improved significantly, driving the output for the “other manufacturing” sector up by 8.2 percent in the financial year under review. The “agriculture” sector rebounded by a substantial 7.3 percent reflecting the push for replanting through the revival of

traditional agricultural initiatives such as the Talomua. An increase of 3.5 percent was registered for the “transport and communication” and 3.1 percent each for “electricity and water” and “public administration” respectively reflecting largely the impact of the South Pacific Games. Also associated with the Games were the higher real output recorded for the “commerce” (up 2.7 percent), the finance and business services” (up 2.6 percent) and “personal and other services” (up 2.6 percent).

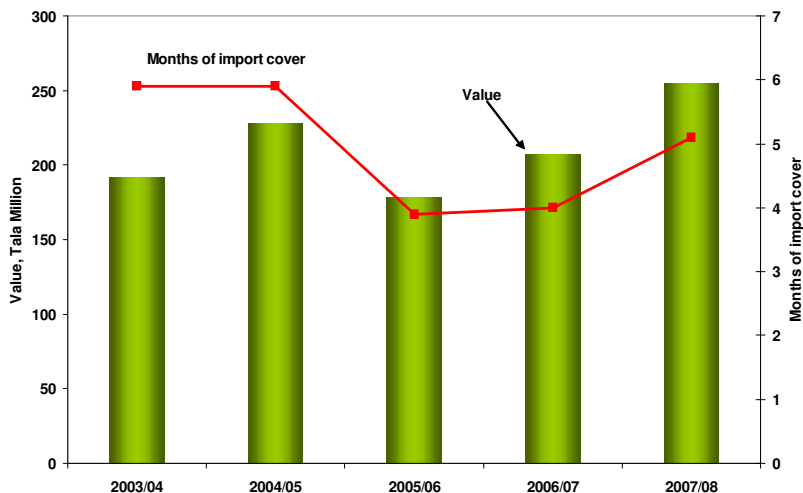
4.2.2 Balance of payments

The balance of payments recorded another favourable outcome in 2007/08, with a substantial overall surplus of \$47.6 million, almost doubled the surplus (\$27.9 million) in 2006/07. This surplus was driven by a significantly lower import bill, continued growths in tourism earnings and private remittances as well as a surge in investment in telecommunication services. (See Table 4.)

During the period	2004/05	2005/06	2006/07	2007/08 Updated	2008/09 Forecast
A. Current Account Balance	-69.5	-70.9	-132.8	-80.2	-148.0
Merchandise Trade Balance	-429.8	-519.9	-585.5	560.7	-618.8
Exports	35.3	29.6	31.3	32.8	32.9
Imports	-465.0	-549.5	-616.7	-593.5	-651.7
Services, net	165.5	185.6	232.2	241.5	215.4
Income, net	-65.5	-24.6	-35.9	-58.4	-56.7
Current Transfers, net	260.3	287.9	256.3	297.4	312.2
Private transfers	244.0	283.7	252.2	291.7	301.1
Official transfers	16.3	4.2	4.1	5.7	11.1
B. Capital Account Balance	149.2	69.5	125.4	67.2	97.6
Official Grants	157.2	71.8	93.6	69.2	99.6
Other	-7.9	-2.3	31.8	-2.0	-2.1
C. Financial Account Balance	-35.2	-39.7	16.9	45.5	106.8
Direct Investment	-5.5	1.4	53.3	8.8	16.0
Portfolio Investment	1.0	0.6	1.8	2.0	2.1
Other Investment	-30.7	-41.8	-38.2	34.7	88.8
D. Reserve Assets	-36.2	49.5	-27.9	-47.6	-43.5
E. Net Errors & omissions	-8.4	-8.3	18.5	15.0	-12.9
Source: Central Bank of Samoa					

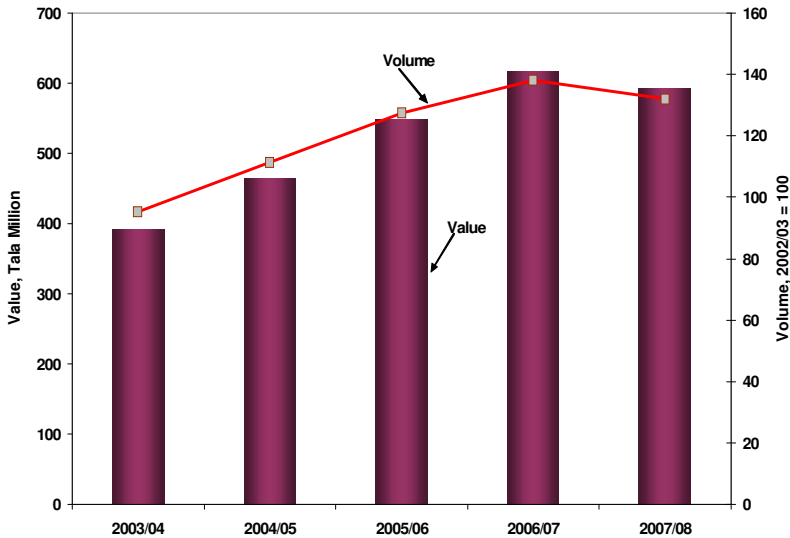
With lower imports, the level of international reserves was elevated to a more comfortable position of 5.1 months, significantly higher than the 4.0 months in 2006/07. (See Graph 5.)

Graph 5 : Gross Official Reserves



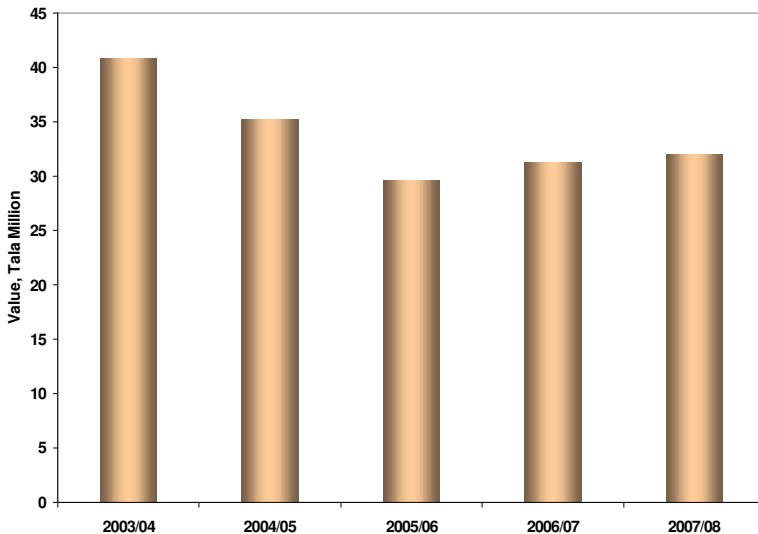
Total imports weakened 4 percent in 2007/08 as non-petroleum imports of the private sector and Government imports declined notably, particularly in the second half of the financial year. Following the announcement for a switch to right hand drive vehicles, the total value of imported motor vehicles by the private sector plunged 50 percent in 2007/08. Reflecting the completion of infrastructural projects for the South Pacific Games, construction materials were also substantially lower, reducing non-petroleum imports by 6 percent, after strong growths in previous years. Government imports likewise fell 27 percent during the financial year. On the other hand, petroleum imports rose 10 percent as its price jumped 38 percent offsetting an estimated 28 percent decline in its volume. (See Graph 6.)

Graph 6 : Imports

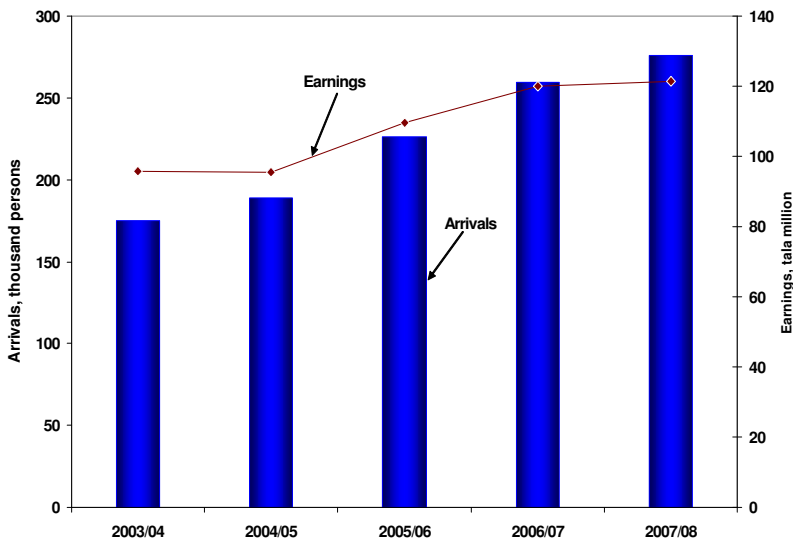


Exports recovered with a modest 2 percent increase in 2007/08. This improvement in exports was driven largely by nonu juice, coconut oil and coconut cream. Re-exports also grew substantially reflecting the improved recording of trade with the Tokelau Islands and higher exports of scrap metals destined for recycling in New Zealand, Australia, Korea and Taiwan. With the rebound in exports coupling the decline in imports, the merchandise trade deficit narrowed 4 percent from the exceptionally high level in the previous fiscal year. (See Graph 7.)

Graph 7 : Exports



As expected, tourism earnings rose 6 percent in 2007/08 reflecting largely the influx of sportspeople for the South Pacific Games in August/September 2007. Visitors from New Zealand and 'other countries' which included most of the athletes and the Games officials from the participating Pacific Island nations were entirely responsible for this positive result, with earnings from these two sectors surging 14 percent and 27 percent respectively. Arrivals from these two destinations, which leapt 8 percent and 25 percent respectively more than offset the decline in arrivals from American Samoa, Australia, Europe and the USA. These pushed total arrivals up 1 percent higher than in 2006/07. With the prices of products and services consumed by tourists trending up further, average tourist expenditure went up 5 percent in the financial year under review. (See Graph 8.)

Graph 8 : Tourism

Private remittances continued to grow to higher levels, rising 16 percent to \$291.7 million in 2007/08. This rise was due mainly to a 13 percent jump in household remittances and a 28 percent hike in transfers for charitable organizations, which came largely from New Zealand, Australia, USA and Fiji. Official current transfers, on the other hand, likewise surged 39 percent to \$5.7 million.

After a large inflow in 2006/07, official capital transfers or project grants declined significantly, driving the capital account surplus down to \$67.2 million from \$125.4 million in 2006/07. On the other hand, the financial account registered notable outflows associated with increased disbursement of Government loans as well as lower commercial banks foreign assets.

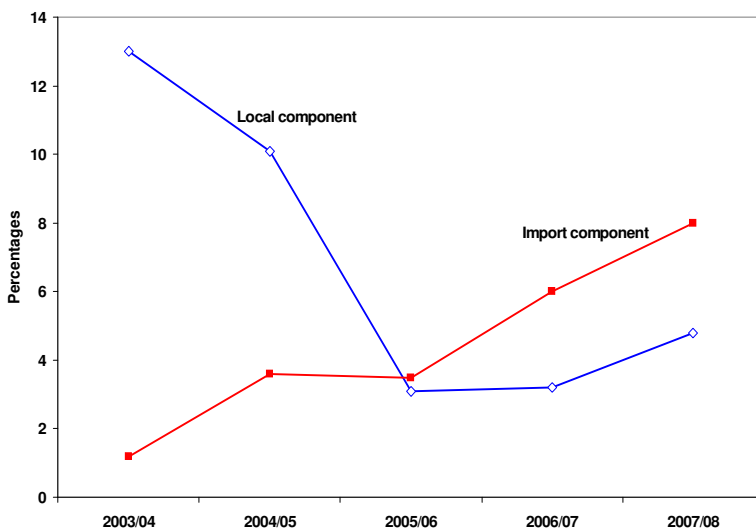
4.2.3. Prices

Consumer prices were influenced by both local and external pressures, with the latter having a more prominent impact. In

2007/08, international prices for a wide range of commodities, particularly oil and food, increased strongly, reaching record levels on a monthly basis. These untimely surges in international commodity prices along with the appreciation of the New Zealand and Australian dollars over the year pushed imported inflation further to record an 8.0 percent increase in the twelve months to end June 2008 from 6.0 percent in the period to end June 2007.

On the other hand, the local component of the headline Consumer Price Index (CPI) posted an annual increase of 4.8 percent at end June 2008, which was above the 3.2 percent at end June 2007. The major contributing factors were the high local fuel costs which caused two separate increases in the fuel surcharges on electricity rates, increased prices for agricultural produce, fish and some food items (such as bread as a result of higher prices for imported flour). In addition, there were significant increases in student registration fees at the National University of Samoa effective in January 2008. (See Graph 9.)

Graph 9 : Headline Consumer Price Index

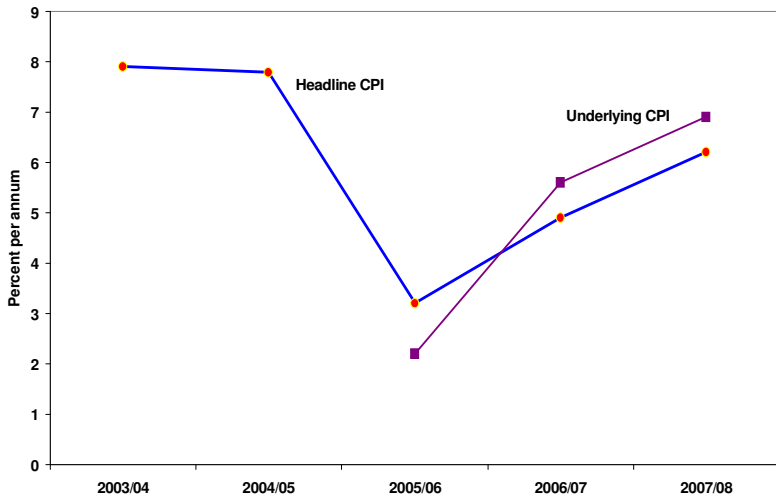


As a result of the higher local and import components of the headline CPI, the headline annual inflation rate accelerated to 6.2 percent at end June 2008 from 4.5 percent at end 2006/07.

Similarly, the annual underlying inflation rate trended upwards to reach 6.9 percent in 2007/08 from 5.6 percent in the previous fiscal year. This upward trend in the year under review was partly attributed to strong aggregate demand. (See Table 5 and Graph 10.)

Table 5					
Consumer Price Index					
(March 2004 = 100)					
Fiscal year to end June	2004/05	2005/06	2006/07	2007/08	2008/09 Forecast
A. Headline Inflation					
	12 months average percent change				
Description					
All Groups	7.8	3.2	4.9	6.2	7.0
Food	10.8	2.1	6.4	7.1	6.0
Clothing and Footwear	-6.3	-7.3	-3.3	-1.4	2.8
Housing and Household Operations	3.9	6.2	2.6	6.9	6.2
Transport and Communication	3.8	10.0	-1.1	4.7	14.1
Alcohol and Tobacco	-0.1	1.2	11.1	6.7	4.6
Miscellaneous	0.7	0.4	3.2	4.0	6.1
Import Component	3.6	3.5	6.0	8.0	8.2
Local Component	10.1	3.1	3.9	4.8	5.9
B. Underlying Inflation (1)					
	year on year end percent change	12 months average percent change			
Description					
All Groups	-0.4	2.2	5.6	6.9	6.7
Food	-0.7	3.0	6.5	7.9	7.4
Clothing and Footwear	-8.1	-7.3	-3.3	-1.4	2.8
Housing and Household Operations	3.1	1.5	0.5	4.7	1.4
Transport and Communication	0.9	1.4	7.1	15.6	15.5
Miscellaneous	1.3	0.9	6.6	2.9	6.4
Import Component	-1.5	1.9	5.8	6.8	6.2
Local Component	3.1	3.0	4.9	7.1	8.3
Source: Statistical Services Division, Ministry of Finance					
(1) The historical series for this new index started in August 2003.					

Graph 10 : Annual Average Inflation Rates



5. DOMESTIC ECONOMY OUTLOOK FOR 2008/09

Government Budget

In July 2008, Parliament approved another expansionary Government Budget for 2008/09. The Budget for 2008/09 is projected to result in an overall deficit of \$84.8 million, substantially larger than the \$14 million deficit for fiscal year 2007/08. In terms of Government Financial Statistics (GFS), this budget deficit is equivalent to 6 percent of nominal GDP, which is up from the 1.1 percent ratio for the previous fiscal year. This large overall deficit, to be financed largely by external soft term loans, reflects increased spending on public and social infrastructural developments, including large education and health investment projects, which were put on hold while Government focused on preparations for hosting the 2007 South Pacific Games.

Total expenditures for 2008/09 is therefore projected to increase by 16 percent over the 2007/08 financial year. Total revenue and grants, on the other hand, is expected to rise slightly, with external grants surging 44 percent to virtually account for the entire increase in revenues and grants. (See Table 6.)

During the period	2004/05	2005/06	2006/07 Budget	2007/08 Budget	2008/09 Budget
Total Revenue and Grants	524.4	387.1	461.5	500.1	510.7
Total Revenue	283.0	315.3	363.0	423.1	400.0
Tax	242.2	273.1	317.9	358.7	340.6
Non-tax	40.9	42.2	45.2	64.5	59.4
External Grants	241.4	71.8	98.5	76.9	110.7
Total Expenditure	521.4	391.7	477.6	514.0	595.5
Current Expenditure	236.6	281.9	325.1	401.5	379.0
Development Expenditure	263.8	86.1	131.7	108.2	216.1
Net Lending (1)	21.0	23.7	20.7	4.4	0.4
Overall Surplus / Deficit (-)	3.1	-4.6	-16.1	-14.0	-84.8
Financing	-3.1	4.6	16.1	14.0	84.8
External Financing	15.8	6.2	17.8	17.7	91.5
Disbursements	27.6	19.2	33.3	31.2	105.4
Amortisation	11.8	13.0	15.5	13.5	13.9
Domestic Financing	-18.9	-1.6	-1.7	-3.7	-6.7
Monetary system	-19.0	-11.0	0.0	0.0	0.0
Other	0.1	-12.6	-1.7	-3.7	-6.7

Source: Ministry of Finance

Real Sector

The sizeable expansionary fiscal policy is one of the major factors that will drive the economy in 2008/09. Projects for strengthening the education, health, agriculture and water sectors in addition to the continuation of infrastructural road works are earmarked to start in the fiscal year under review. These are expected to combine with the continuing rise in commodity export prices and further growths in tourism earnings and private remittances to post further positive growth in the real sector.

In the event, real GDP is expected to grow by about 3 percent in 2008/09, driven by all sectors except for “other manufacturing” (which is expected to face tough international competition) and the “fishing” industry. The “commerce” sector, which is the largest sector of the economy, is anticipated to

grow by 6 percent, followed by “public administration” (up 5 percent), “finance and business services” and “hotels and restaurants”(up 4 percent each), and “agriculture” “constructions”, “electricity and water and “transport and communication” sectors (up 3 percent each).

Balance of Payments

The balance of payments is expected to record another favourable outturn in 2008/09. Given the expansionary Budget for the current fiscal year, net disbursement of Government external loans is anticipated to amount to \$90.0 million which would be a fivefold increase from the previous fiscal year. This would be the largest net external loan disbursement in ten years. This significant injection would see the financial account posting a net inflow of \$106.8 million, more than double the inflow in 2007/08. Similarly, a surge in project grants would push the capital account surplus to a level 45 percent higher than the surplus in the previous fiscal year.

On the current account, exports for 2008/09 are anticipated to increase slightly to \$32.9 million. This improvement is expected to come from coconut oil, beer, purified water (new export commodity) and re-exports, offsetting the projected decline in fish, coconut cream, nonu juice and nonu fruit. Boosted by a strong demand for cosmetics from the UK and New Zealand, proceeds from coconut oil are projected to more than double the pilot testing level in 2007/08. Beer is anticipated to recover by 5 percent mainly with an anticipated improvement in exports to American Samoa, while the export of purified water, which is expected to begin in the current fiscal year, is projected to earn \$1.2 million. With the export of scrap metals and trade with the Tokelau Islands expected to increase further, re-exports are forecast to improve slightly.

Given the current global instability in commodity markets, particularly those of crude oil, a moderate rise in the volume of petroleum imports is anticipated in 2008/09. And, with import

prices projected to remain generally higher than the previous fiscal year, the total value of petroleum imports for 2008/09 is expected to surge by 37 percent to \$185.1 million. Similarly, private sector imports are envisaged to improve by more than 2 percent, in line with the anticipated growth of the economy. This projection reflects largely a pick up in the import of (right hand drive) vehicles and construction materials. On the other hand, the volume of Government imports, which is projected to decline by 9 percent, is expected to offset an increase in import prices to result in the total value of Government imports declining by 6 percent. Overall, therefore, the total value of imports is anticipated to increase by 10 percent in 2008/09.

Strong tourism activities are expected to continue in 2008/09. Tourism earnings are anticipated to increase by a further 5 percent to \$290.1 million despite a decline in tourist arrivals, following the strong influx for the South Pacific Games in August/September last year. Like in the previous financial year, the bulk of tourism earnings is expected to come mainly from New Zealand and Australia. Private remittances likewise are anticipated to rise 5 percent to \$306.2 million to be driven entirely by a 7 percent jump in household remittances. Transfers by charitable organizations are expected to decline during the year.

In the event therefore, the balance of payments is expected to post another large overall surplus of \$43.5 million in 2008/09, albeit slightly lower than the surplus in the previous financial year. Although imports are expected to pick up strongly in 2008/09, the level of international reserves is anticipated to strengthen further to 5.5 months of imports, well above the minimum target of 4.0 months.

Prices

Consumer prices in 2008/09 are expected to follow much the same trend as in 2007/08. With the more pronounced volatility in international commodity markets and financial markets, it is

expected that external factors would be largely responsible for driving the headline CPI. Domestic pressures associated with the spill-over effects of global developments as well as the projected real growth are also anticipated to contribute, driving both the headline and the underlying inflation rates notably higher than the long term annual inflation rate target of 3.0 percent.

Headline Inflation

Import component

The upswing in commodity prices particularly oil and food is expected to exert significant pressures on the import component of the headline CPI in 2008/09. Although the latest IMF forecasts in the *July 2008 World Economic Outlook* point to a global decline in food prices over the year, they will still remain well above its historical averages. As a result, imported food price inflation is expected to peak at 8.3 percent in December 2008 before declining to 6.2 percent at end June 2009 from 8.0 percent at end June 2008. Similarly, international oil prices are anticipated to remain higher and volatile, although a moderate decline is expected. This would see the import component of the “Transport and communication” group soar 23 percent on an annual average basis in 2008/09, in contrast to a 19 percent increase in the previous fiscal year. Kerosene prices will also be affected by these volatile fuel prices, pushing the “Housing and household operations” sub-index up by 8.8 percent at end June 2009 from 6.3 percent at end June 2008. These considerable price movements would result in an imported inflation rate of 8.2 percent for 2008/09, up slightly from 8.0 percent in 2007/08.

Local component

The domestic headline inflation rate is expected to elevate to 5.9 percent in 2008/09 from 4.8 percent in the previous financial year. Reflecting largely the domestic costs of surging

international oil and food prices, all groups are anticipated to increase, with the “transport and communication”, “food” and “alcohol and tobacco” projected to exert significant influence on domestic inflation. With taxi and bus fares expected to increase during the financial year under review, the “transport and communication” group is anticipated to soar 8.6 percent in 2008/09, in contrast to a 0.6 percent decline in 2007/08. There were, however, unexpected increases in Samoa Tel’s services in early August 2008, in particular the local calling rates and the phone line rental charges and therefore it is expected that the “transport and communication” sub-index could be higher than originally expected. Domestic food inflation, likewise, is expected to record another 5.8 percent increase above a similar expansion in 2007/08. This projection reflects strong demand associated with real economic growth expected for 2008/09, the 10 percent increase in excise tax on soft drinks that was effective on 1 July 2008 and another surge in bread prices as a result of rising electricity rates and flour prices. These increased prices will be partially offset by an expected improvement in the supply of local agricultural produce particularly with Government’s *Talomua* program gaining momentum throughout the country. With the effective 10 percent increase in the excise tax on alcohol and tobacco on the 1st July 2008, the “Alcohol and tobacco” sub-group is expected to post another 4.7 percent increase on top of a 6.7 percent rise in 2007/08.

Headline Inflation Rate

Overall, the significant expansionary budget combined with strong domestic demand and volatile global conditions will exert substantial inflationary pressures in 2008/09. The annual headline inflation rate is therefore expected to accelerate, initially reaching 7.9 percent at end March 2009 before slowing down to 7.0 percent at end June 2009.

Underlying Inflation

Import Component

It is anticipated that the overall import component of the underlying CPI will fluctuate within the next twelve months before steadily declining to 6.2 percent from 6.8 percent at end June 2008. This projection reflects some moderation in prices, with an expected depreciation of the Australian and New Zealand dollars and a modest easing of commodity prices in the global markets. Domestic prices are likely to remain high and consequently also influence imported prices in the underlying CPI.

Local component

On average, the domestic underlying inflation rate is expected to soar to 8.3 percent at end June 2009 from 7.1 percent at end June 2008. Underpinning this upward projection is an expected boom in local food prices associated with the general strength in domestic demand in the next twelve months. Partially stemming this upward pressure will be a projected slowdown in prices of commodities in the “Housing and household operations” and “Transport and communication” sub-indices.

Underlying Inflation Rate

All in all therefore, the underlying inflation rate is expected to fluctuate during the year before declining to 6.7 percent at end June 2009 from 6.9 percent at end June 2008.

6. MONETARY POLICY STANCE FOR 2008/09

The Samoan economy is expected to continue with its growth momentum, posting a further expansion of 3.0 percent in 2008/09, on top of an annual growth of 3.9 percent in 2007/08. This growth is expected to be driven by substantial public sector projects, further increases in tourism earnings, private remittances and grants from abroad. Exports are anticipated to improve slightly while imports are projected to rebound strongly. In the event, with the external sector expecting a favourable outcome, especially with significant disbursement of external loans, the balance of payments is forecast to record another healthy overall surplus that will push the level of international reserves up further to a comfortable position of more than 5 months of import of goods.

On the other hand, inflation is expected to continue to accelerate during the year as international commodity prices, particularly of oil and food, trend up further. Although the prices are anticipated to decline later in the year, they will still remain above their historical averages. The annual headline inflation rate is therefore likely to reach a high of 7.9 percent at end March 2009 before slowing down to 7.0 percent at end June 2009. Similarly, the underlying inflation rate is anticipated to accelerate during the year before declining to 6.7 percent at end June 2009 from 6.9 percent at end June 2008.

Aside from inflation, which is predominantly been driven by the high levels of international commodity prices, the slowdown in private sector investment demand is most concerning, with the growth rate in credit to that sector substantially down from the high levels of the previous years. To encourage and stimulate activity in the private sector, monetary policy has been relaxed in 2008/09, following two years of tightening. The main focus of this eased policy stance is on supporting and strengthening further private sector development and growth. In a way, this should help reduce the high prices of imported food items thereby reducing inflation. Local production needs to be

encouraged to increase domestic supplies. Market interest rates are therefore expected to decline in 2008/09, reducing the cost of production and hence encouraging the development of sectors like agriculture, manufacturing, renewable energy and tourism.

In effect, monetary aggregates are expected to grow strongly in 2008/09. Following a slow annual growth of 6 percent in 2007/08, bank credit to the private sector is anticipated to surge 12 percent in 2008/09. This, combined with an expected larger net inflow of foreign funds during the year would see total money supply (M2) posting a similar annual growth of 11 percent as that in 2007/08. These growth rates however are much lower than in 2005/06 and 2006/07. (See Table 7.)

End of Period	2004/05	2005/06	2006/07	2007/08	2008/09 Forecast
A. Determinants of Money Supply					
Net Foreign Assets	231.3	184.6	199.1	227.8	263.2
Net Domestic Assets	209.9	313.9	342.6	379.8	418.7
Government's Net Position	-100.3	-89.3	-100.6	-88.7	-95.4
Bank credit to private sector	383.0	490.9	548.3	584.1	652.1
Bank credit to public institutions	10.3	28.5	55.3	67.6	68.0
Others, net	-83.1	-116.2	-160.3	-183.2	-205.9
B. Money Supply (M2)					
Narrow Money	441.2	498.6	541.8	607.6	681.9
Currency Outside banks	132.8	145.2	151.0	152.9	177.6
Demand Deposits	30.7	37.0	42.4	40.3	46.0
Quasi-money	102.1	108.2	108.6	112.6	131.7
Savings deposits	308.4	353.4	390.8	454.7	504.3
Time deposits	55.8	64.3	71.2	73.8	109.5
Foreign Currency Deposits of Residents	239.5	269.4	309.9	360.1	370.7
Foreign Currency Deposits of Residents	13.1	19.7	9.7	20.8	24.1

Source: Central Bank of Samoa

This monetary policy stance will be reviewed after six months or earlier if necessary.
