CENTRAL BANK OF SAMOA

Central Bank of Samoa's Monetary Policy Framework

Monetary Policy Objective

The primary aim of the Central Bank's monetary policy is to **achieve and maintain price stability**, which is also the Bank's primary objective. This ensures the volatility and uncertainty in inflation is reduced and adequately managed thereby enabling long-term economic growth and investments to flourish. The CBS continues to quantify Samoa's targeted inflation rate consistent with its major trading partners at an annual average inflation rate of 3.0 percent in order to pursue and achieve its price stability objective. This naturally determines the target that the CBS seeks to maintain each year while also acknowledging the impact of external shocks on price volatilities which are beyond CBS' monetary policy control. Past years' experiences reveal that persistent sharp hikes in international prices for globally traded commodities such as crude oil and imported food had exerted significant pressures on the domestic prices of petroleum and food items. Similarly, domestic supply shocks (such as food shortages following natural disasters like cyclones) have the same upward pressure on domestic prices. During such periods, the focus was mainly on the underlying (core) inflation rate.

Consistent with its primary monetary policy objective, the CBS is also committed to safeguarding Samoa's macroeconomic stability in view of the Government's PDS, for the improved livelihood and betterment of Samoa and its people. This refers to achieving sustainable real economic growth, defined as real GDP growth of around 3.0 percent for the Samoan economy in the medium term.

Complementing our monetary policy objective is maintaining a comfortable level of official foreign exchange reserves for the country. Samoa is a small but highly open economy with total merchandise trade representing around 60-65 percent of nominal gross domestic product (GDP). Total earnings from exports of goods account roughly for one tenth of total import payments every year. It is crucial therefore that Samoa maintains a sufficient level of international reserves to withstand the many unanticipated economic shocks (both natural and man-made). CBS, under prevailing circumstances, targets or considers a level of gross official international reserves to be adequate or comfortable at an equivalent of no less than 4.0 months of imports of current goods.

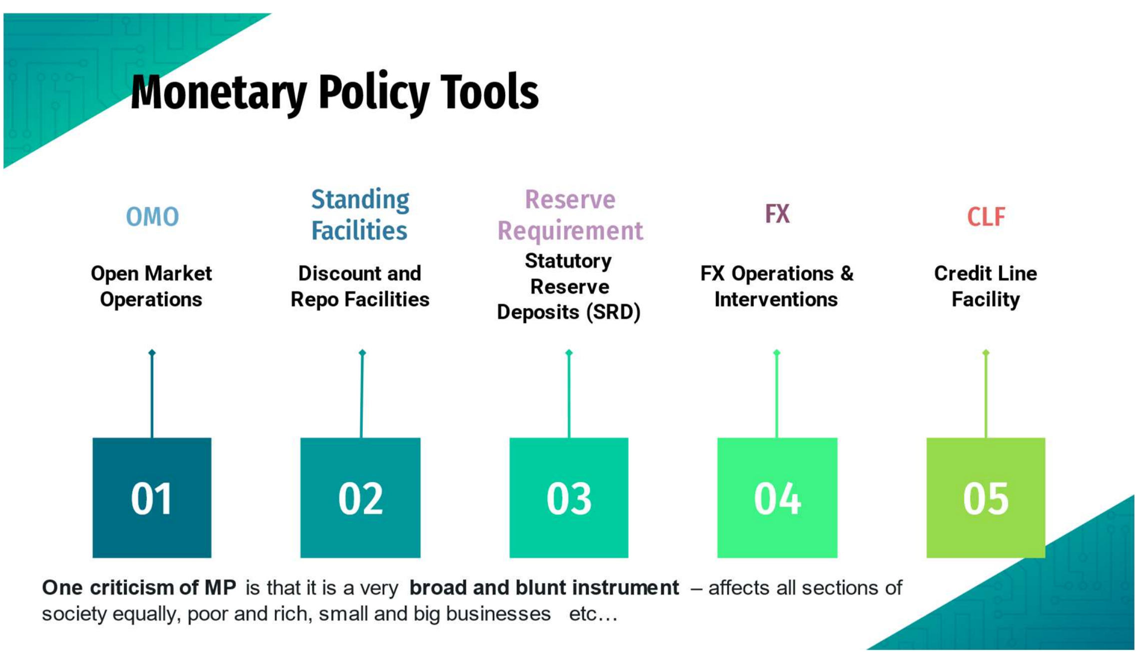
Another goal under third objective is **ensuring a comfortable level of official foreign reserves** for the country. Samoa is a small but highly open economy with total merchandise trade representing around 60-65 percent of nominal gross domestic product (GDP). Total earnings from exports of goods account roughly for one tenth of total import payments every year. It is crucial therefore that Samoa maintains a sufficient level of international reserves to withstand the many unanticipated economic shocks (both natural and man-made). CBS, under prevailing circumstances, targets a level of gross official international reserves of no less than 4.0 months of imports of goods, sufficient to maintain Samoa's adequate level of long-term foreign reserves.

Similarly, our monetary policy is supported by Samoa's exchange rate policy, which aims to having an appropriate level of exchange rate that is conducive for promoting exports of goods, visitor earnings and remittances inflows while also mitigating imported inflation. In particular, the CBS's Exchange Rate policy (ERP) ensures that export-oriented industries remain competitive in overseas markets whilst 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 its international competitiveness through its export sector. At the same time, it aims to avoid a substantial depreciation of the Tala given its subsequent effect on imported inflation. This is one area the CBS is closely monitoring since the onset of the COVID-19 pandemic. The CBS continues to monitor and assess on a quarterly basis its exchange rate basket as well as actively consulting with the IMF through its annual Article IV Missions, to ensure Samoa's Exchange rate regime and policy remains appropriate given prevailing macroeconomic conditions.

Monetary Policy Tools

The main monetary policy tool employed by the Bank are:

1. Open Market Operations (OMO) through the buying and selling of CBS Securities to indirectly influence commercial banks interest rates (deposit and interbank rates). The interest rate bids on CBS securities that are issued through OMO is used to influence commercial banks interest rates (deposit rates). The CBS also offers standing facilities such as the discount and repurchase facilities on the CBS securities.
2. Another monetary policy tool within the CBS toolbox is the reserve requirement ratio which is also called the Statutory Reserve Deposit (SRD). This ratio is currently around 4.5 percent of commercial banks' deposit liabilities. The SRD can directly influence the level of commercial banks' liquidity and subsequently, the level of money supply.
3. The CBS may also utilise its exchange rate policy
4. Foreign exchange control and operations (buying and selling of foreign currencies with commercial banks) as another means to achieve its policy objectives.
5. The Credit Line Facility – a non-traditional tool used at rare occasions to inject liquidity at below prevailing market interest rates as a means to bring down market interest rates. This monetary policy tool is only available to selected public non-bank financial institutions and was introduced in 2009 during the Global Financial Crisis.



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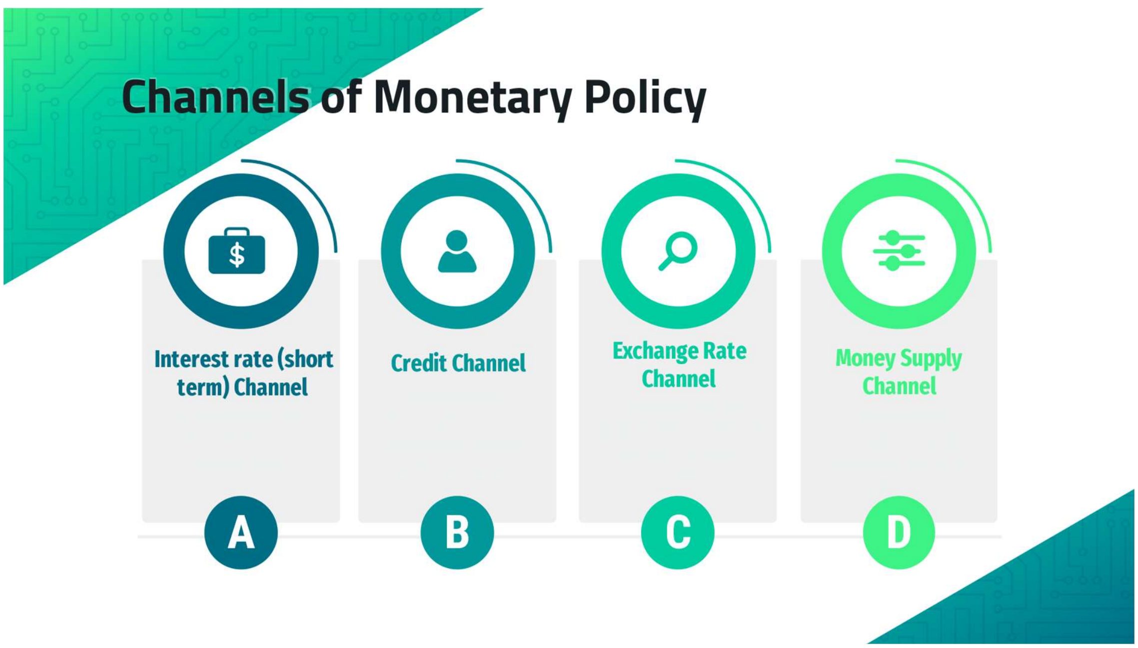
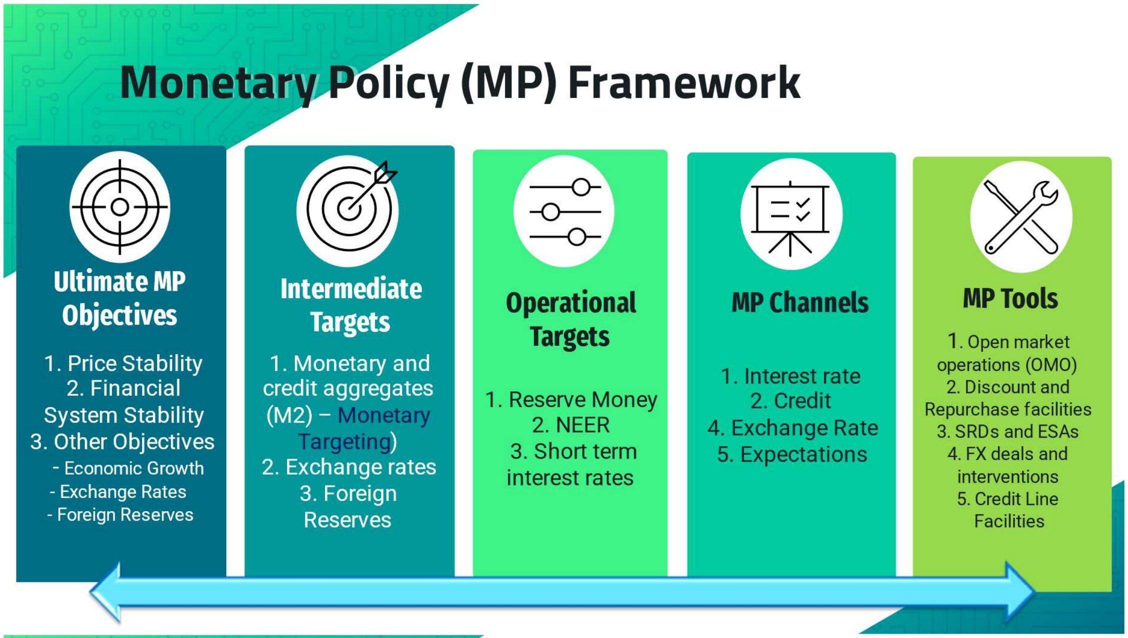
Monetary Policy Channels and Transmission

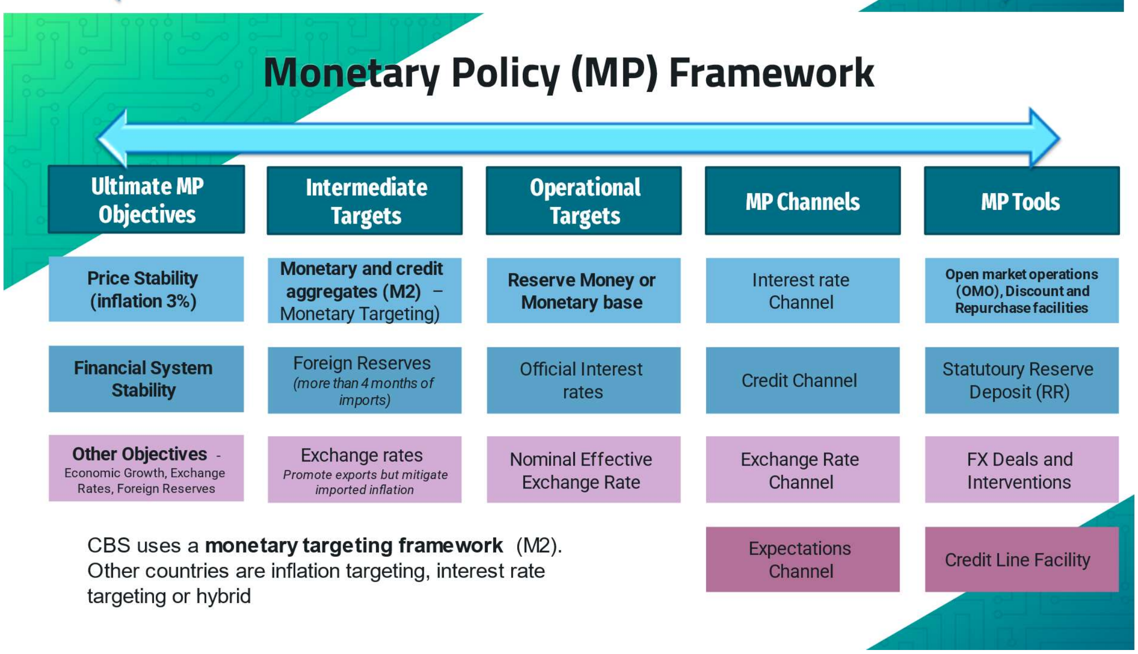
1. Interest rate Channel. Monetary policy decisions are usually conducted via open market operations (OMO) through the issuance and trading of CBS Securities (CBSS) to influence market interest rates and thereby influence the level of credit and investment and ultimately inflation and aggregate demand and output. This is transmitted through the money market Interest rate channel.
2. Exchange Rate Channel. Through its foreign exchange rate policy and operations, monetary policy may be transmitted through its impact on domestic prices of imported commodities.
3. Credit Channel. Through moral suasion, commercial banks are encouraged to increase or decrease their lending to the private sector (depending on the monetary policy stance) from time to time. This influences the level of consumption and investment in the economy, contributing to stable inflation and economic growth.
4. Money supply channel where the CBS uses the bank reserves (ESA and in rare cases SRD) to inject or withdraw liquidity from the reserve money, thereby influencing short term market interest rates and influence investment and impact aggregate output.



Monetary Policy Framework

The CBS employs a monetary (aggregates) targeting policy framework. This means that the CBS targets a monetary variable, which in this case is money supply (M2) or broad money, in order to influence its primary objective of inflation. Under this framework, money supply is the intermediate target to achieve its price stability objective. Remember, the relationship between money and inflation? In theory, if we reduce the level of money in an economy, this will lower demand and spending, which will ultimately bring down prices and reduce inflation (and vice versa). On a day-to-day basis, the CBS uses an a more operational variable i.e. OMO (weekly buying and selling of CBS securities) to achieve its intermediate target of M2.





Monetary Policy Formulation and Decision-Making Process

The process of formulating monetary policy for the CBS is done bi-annually or twice a year. First one starts in April and culminates with a proposed monetary policy stance presented to the CBS board by end June every year in preparation for the start of a new financial year in July. The second one starts from October and a proposed (updated) monetary policy stance is presented to the Board in December. This presents a 6-month cycle of forecasting and reviewing of monetary policy.

The process of formulating monetary policy starts 7 weeks prior to the proposed date of presenting a proposed monetary policy stance to the CBS Board. The responsibility lies with the Economics Department (ED) and Financial Markets Department (FMD), which includes collecting, updating and compiling initial forecasts of selected core macroeconomic indicators. These forecasts are then presented by staff of both departments and discussed at the Monetary Policy Working Group (MPWG), which is chaired by the Deputy Governor Policy Group. Once an agreed monetary policy outlook is determined, the MPWG then coordinates with the Ministry of Finance (MoF) and the Samoa Bureau of Statistics (SBS), as part of the Macroeconomic Forecasting Committee, where the broader macroeconomic forecasts are discussed. This is an opportunity to cross check growth forecasts with the Economic Policy Planning Division of MoF to get views from the fiscal side.

The MPWG co-ordinates the collection of data, analyses, and presents for discussion the monetary policy forecasts to the CBS Monetary Policy Committee (MPC). The MPC consists of the Governor of CBS, Deputy Governor Policy Group, Deputy Governor Operations Group, Manager of Financial Supervision and Regulatory Services Department (FSRSD), Manager ED and Manager FMD. Following the MPC, the final monetary policy stance and economic outlook is presented to the CBS Board of Directors, for their endorsement (by consensus) before the end of June each year.

A press release is prepared and disseminated immediately following the CBS Board Decision, to announce the new monetary policy direction/stance for the new financial year. The CBS will also put out later, a monetary policy statement report that details the underlying factors and assumptions of CBS outlook and its approved monetary policy stance. This approved monetary policy stance is then reviewed after six months and the whole 7-week forecasting process starts anew in October.

While FMD implements monetary policy decisions, the MPWG provides feedback to and takes direction from the MPC regarding operational and policy matters.