

FOREWORD BY THE GOVERNOR

This is the second Monetary Policy Statement (MPS) to be issued by the Central Bank. In line with the strategies outlined in its *Corporate Plan for 2001-2002* and *Government's Strategy For The Development of Samoa 2002-2004*, this MPS presents the macro-economic forecasts reflecting the Central Bank Board's decision regarding the stance for monetary policy in 2002/2003. The MPS is issued following the Board meeting that was held in July 2002.

The MPS is presented on a financial year basis in accordance with the amendments in September 2001 to the Central Bank of Samoa Act 1984. The financial year covers the twelve months period from July to June to coincide with the Government Budget, which is also presented on a fiscal year basis.

Most central banks around the world, including those in the Pacific, issue Monetary Policy Statements (MPS) at least once a year. The main objective for issuing a Monetary Policy Statement is to inform the general public, local and overseas, of the outlook for monetary policy for the financial year ahead. And, in line with Government's emphasis on transparency and accountability, the MPS aims to disclose and explain to the public the main monetary policy objectives and targets that will be pursued by the Central Bank in the year ahead.

Given that the historical economic developments have already been well covered in the Central Bank's monthly and quarterly publications, the MPS focuses more on the outlook for the next twelve months. It is divided into six Sections. After introductory remarks in Section 1 and the Overview in Section 2, Section 3 provides a summary of the latest economic developments. The outlook for developments in the world economy in the next twelve months is presented in Section 4, followed by the outlook for the Samoan economy in Section 5. The latter section provides an overview of the Government Budget, the outlook for the real sector,

balance of payments, foreign exchange reserves and inflation in 2002/2003. The last section, Section 6, provides the Central Bank's intended stance for monetary policy and related policy instruments for the year to end June 2003.

We trust that the general public will find this document useful in guiding their investment as well as their social decisions in the next twelve months.

Soifua

Papalii T. Scanlan
GOVERNOR

September 2002

1. INTRODUCTION

In line with the Central Bank's Corporate Plan for 2001–2002 and Government's Statements of Economic Strategy, which are now known as the Strategy For The Development of Samoa, 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 2001/2002 where a number of significant factors influenced Samoa's annual rate of inflation. These included the increased international price of crude oil worldwide, 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, the strict enforcement of required sizes of fresh fish that could be sold throughout the country and the very wet and windy weather conditions in the eight months to June 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

As expected, the world economy weakened in 2001/2002 with gross domestic output in most of the advanced economies remaining sluggish throughout the year. In addition to a general slowdown in global demand, the frail world economy was further depressed by the decline in consumer and business confidence following the September eleven attacks on New York and Washington D.C. plus the subsequent retaliation by the USA. Latest information showed that the world economy grew by 2.7 percent in 2001/2002, which was significantly down from 3.6 percent in the previous financial year.

The outlook for the immediate future is still uncertain, blurred by the accounting scandals and the aftermath of the September eleven attacks on America, the possibility of an attack by the USA on Iraq, natural calamities particularly the record flood levels in some parts of Europe and Asia and the fragile financial outlook for the Latin American region.

The Samoan economy also slowed down in the financial year 2001/2002, with real GDP growth rate falling to 1.7 percent from 8.6 percent in the fiscal year to end June 2001. The domestic rate of inflation rose to 7.4 percent in the year to end June 2002 from 1.9 percent in the previous fiscal year. The absolute level of net foreign assets in 2001/2002 improved but the strength of foreign reserves (relative to the growth of imports) declined.

Domestic macro-economic conditions are, however, expected to improve in 2002/2003. Real economic growth is expected to be boosted by the continuation of expansionary fiscal and monetary policies. The annual rate of inflation is expected to slowdown to around 3.5 percent and the level of international reserves is expected to remain healthy at the equivalent of around 4.3 months imports.

3. RECENT DEVELOPMENTS

3.1 World Economy

World economic activity is recovering from last year's sharp meltdown, albeit at a very weak pace. While the global economy grew in real terms by 2.7 percent in 2001/2002, growth is expected to rise to 3.4 percent in 2002/2003. There is some confidence that the health of the global economy will return to full strength in calendar year 2003. Inflation, on the other hand, looks set to decline to 1.6 percent in 2002/2003 from 1.8 percent in 2001/2002. (See Table 1.)

Fiscal year to end June	1999/00	2000/01	2001/02	2002/03 Forecast
	(Percent)			
Real growth rate	4.2	3.6	2.7	3.4
Inflation rate	1.8	2.3	1.8	1.6
Official international interest rates,	(End of period, percent p.a.)			
US Federal Reserve	6.50	3.75	1.75	1.75
Reserve Bank of Australia	6.00	5.00	4.75	4.75
Reserve Bank of New Zealand	6.50	5.75	5.75	6.25
Bank of Japan	0.50	0.25	0.25	0.25
Bank of England	6.00	5.25	4.00	4.00
European Central Bank	3.50	5.25	3.25	3.25
Reserve Bank of Fiji Notes, 91 days	5.00	1.43	1.25	1.25

Source: IMF and reserve banks' publications and information releases.

At the time we went to press, the US economy appeared to be weaker than late in the first half of 2002. The annualized real GDP growth rate for the US economy was 1.1 percent in the second quarter of 2002 compared to 5.0 percent in the first quarter. This was highlighted by a succession of corporate scandals as well as weakness in the US equity markets. Consumer confidence had its steepest fall in July 2002 since the September 11 terrorists attacks. Recovery in the manufacturing sector lost its grip while growth in the services industry softened.

The Australian economy posted strong performances in the first and second quarters of 2002. Consumer confidence remained high, translating to increases in dwelling investments, household consumption and improvement in exports. As a result, the Reserve Bank of Australia (RBA) started to tighten monetary policy in May 2002. However, with signs emerging that the recovery in world growth is very weak, there are also signs that the Australian economy is also slowing down. Business surveys suggest that consumer demand has softened and housing construction, the key driver of the economy in 2001, has peaked. The drought currently gripping the Australian farming sector will also be a drag on the Australian economy.

The New Zealand economy is enjoying relatively solid growth. Real GDP grew at an annual rate of 4.0 percent at the end of the March 2002 quarter, the strongest rate of growth in almost two years. However, as the odds of an international economy slowing down increases, this would have a negative impact on the NZ economy.

Japan is at long last experiencing an upturn in economic activity. Real GDP rose by 1.4 percent in the March quarter of 2002 after three consecutive quarters of declines. Consumer spending and business confidence have shown some improvement.

After a disappointing growth figure in the December quarter of 2001, the Euro area's real GDP grew by only 0.2 percent in the March quarter in 2002. Headline inflation has fallen below 2 percent for the first time in two years reflecting lower petrol and food prices.

On official interest rates, the US Federal Reserve Bank has left its funds rate at a 40 year low of 1.75 percent. Interest rates are likely to remain lower in the US than in most other countries for longer than previously thought. The European Central Bank and the Bank of England have also kept rates on hold at 3.25 percent and 4.0 percent respectively. Across the Pacific, the Reserve Bank of New

Zealand (RBNZ) was the first to start the tightening cycle followed by the RBA. The RBNZ has already raised the official cash rate by a total of 100 basis points and the RBA by 50 basis points in the first eight months of 2002.

On exchange rates, the US dollar's strength sustained in 2001 has finally come to an end. The Greenback has fallen by about 9 percent in the seven months to August 2002 from its February 2002 peak against other major currencies. The strength of the USD stemmed from its ability to attract capital in the form of foreign direct investment and purchases of equities and corporate bonds to finance the US current account deficit. Lately, however, the corporate scandals have weakened the confidence of investors in US companies and made US assets less attractive resulting in capital outflows. This also contributed to widening the current account deficit, which consequently weakened the US dollar. Other factors such as a deteriorating fiscal position and low interest rates relative to its trading partners will weigh on the US dollar in the near term.

The Australian (AUD) and New Zealand (NZD) dollars have strengthened in July and August 2002 on the back of a weak US dollar and strong domestic economies. The AUD appreciated to a high of 57 US cents while the NZD approached 50 US cents in June 2002. However, concerns that the growth of the world economy may be faltering saw the AUD retreat to above 53 US cents and the NZD at 46 US cents in August 2002.

The Yen strengthened against the US dollar and was trading in the range of Yen 117-120 to the US dollar in August 2002. Although Japan looks as if it has come out of recession, investors are still weary about deflation and the unhealthy banking sector of that country.

3.2 *Domestic Economy*

Available figures indicate that the Samoan economy grew in real terms by 1.7 percent during the fiscal year to end June 2002. This outcome contrasted substantially with the expected real growth rate of 4.0 percent. The drastic deviation of the actual outcome from expectation reflect mainly the sharp decline of real output during the first quarter of 2002. Real GDP declined 3.8 percent in the March 2002 quarter to a level 0.4 percent lower than in the same quarter in 2001. The slump in the first quarter of 2002 reflected the downturn in construction activities of the Government and private sector, a sharp reduction in fish exports, a fall in tourism earnings and a decline in agricultural production. (See Table 2.)

Much of the 1.7 percent real growth for the financial year 2001/2002 occurred in the six months to December 2001, compliments of the reasonably strong growths during that period in the fishing industry (7.5 percent), 'other manufacturing' (16.1 percent), 'electricity and water' (16.8 percent), 'commerce' (6.3 percent), 'hotels and restaurants (5.5 percent), transport and communication (5.1 percent), public administration (3.0 percent), finance and business service (13.7 percent), ownership of dwellings (2.0 percent) and personal and other services (5.9 percent).

Government's financial operations for the fiscal year to June 2002 closed with an overall deficit of \$17.8 million, equivalent to 2.1 percent of nominal GDP. During this period, Government received net external loan disbursements of \$11.8 million, comprised of gross disbursements of \$23.9 million and loan repayments of \$12.1 million. On the domestic side, Government's net deposits with the monetary system improved \$4.6 million to \$94.2 million.

Table 2				
Selected Domestic Economic Indicators				
Fiscal year to end June	1999/00	2000/01	2001/02	2002/03 Forecast
(Percentage change over the previous year)				
Real sector				
Nominal GDP	8.9	12.5	4.3	6.9
Real GDP	4.4	8.6	1.7	3.0
Prices				
Consumer Price Index (annual average)	-0.1	1.9	7.4	3.5
Implicit GDP Deflator (annual average)	4.2	3.6	2.7	3.9
Monetary aggregates				
Net foreign assets (end of period)	0.8	0.8	1.9	-2.8
Government's net monetary position (end of period)	-3.1	-11.8	5.2	-1.5
Bank credit to private sector				
Annual average	16.7	18.8	14.9	10.6
End period	14.3	21.1	9.9	12.0
Money Supply, M2				
Annual average	15.3	16.2	7.6	7.8
End period	13.4	20.1	3.6	8.8
Exchange rate				
Nominal Exchange Rate	2.03	2.39	-4.58	-4.58
Real Exchange Rate	0.63	0.69	1.68	1.68
International reserves				
(Level at period end)				
Net foreign assets (Tala million)	178.6	179.9	182.2	178.3
Net foreign assets (Months of merchandise imports)	6.8	5.2	4.7	4.4
(End of period, percent p.a.)				
Weighted average interest rates				
CBS 14 days Securities (1)	-	-	3.05	3.05 (6)
CBS 28 days Securities (2)	-	4.85	4.00	4.09 (7)
CBS 56 days Securities (3)	-	4.71	4.75	4.75 (7)
CBS 91 days Securities	5.85	5.60	5.50	5.70 (7)
CBS 182 days Securities	6.35	6.50	6.90	6.76 (7)
CBS 365 days Securities (4)	-	7.00	7.06	7.06 (5)
Commercial bank deposits	4.6	4.5	4.4	4.5 (6)
Commercial bank credit	12.3	11.7	11.6	11.6 (6)
Commercial bank interest rate spread	7.7	7.2	7.2	7.1 (6)
Source: Central Bank of Samoa				
(1) This securities was first issued on 22 February 2002				
(2) This securities was first issued on 05 March 2001				
(3) This securities was first issued on 08 December 2000				
(4) This securities was first issued on 12 January 2001				
(5) Interest rate as at end May 2002				
(6) Interest rate as at end July 2002				
(7) Interest rate as at end August 2002				

The balance of payments recorded an overall surplus of \$2.3 million in the fiscal year to end June 2002 compared with an overall surplus of \$1.4 million in the previous year. This is a remarkable result considering that in the first three quarters of the 2001/2002 financial year, the balance of payments was in the red with an overall deficit of \$13.4 million. However, in the June quarter of 2002, the balance of payments turned around, recording an overall surplus for the

quarter of \$15.7 million. Much of this surplus reflected the substantial increase in capital inflows and earnings from tourism during the quarter.

In the twelve months to end June 2002, total imports expanded 11.4 percent to \$459.9 million on top of a dramatic increase of 31.4 percent in the previous financial year. As a result, the relative strength of Samoa's foreign reserves position, as measured by the ratio of net foreign assets to imports of goods, declined. Net foreign assets fell to the equivalent of 4.8 months imports of goods at end June 2002 from 5.2 months at the end of the previous fiscal year. The decline, however, was not surprising. In fact, it was expected given the anticipated expansion in the demand for imports.

On the inflation front, a number of factors dramatically influenced price developments in 2001/2002. The local component of the Consumer Price Index (CPI) rose 10.5 percent in 2001/2002, the sharpest increase in the past eight years, due mainly to the upward revision in bus and taxi fares (in July 2001), the dramatic rise in the prices of the main agricultural commodities and fish as a consequence of unfavourable weather conditions (between November 2001 and June 2002) and the increased prices for beer and cigarettes (in June 2002). The import component also went up by 3.8 percent, due mainly to the increased prices for petroleum products and inflation in source countries. As a result, and in line with expectations early in the financial year, the annual rate of inflation rose to 7.4 percent in June 2002 from 1.9 percent in the year to end June 2001.

The slowdown in the world economy, which was hastened by the dramatic events of September 11 plus the reduced level of construction activity in the domestic economy, saw the demand for bank credit slow down in 2001/2002. Mindful of the potentially negative impact that this would have on domestic economic growth, an accommodative monetary policy stance was maintained by the Central Bank throughout 2001/2002. The overall level of interest rates on the Central Bank's main instrument for monetary policy –

Central Bank securities – declined. Correspondingly, the weighted average interest rates on commercial bank credit fell to 11.61 percent in the twelve months to end June 2002 from 12.09 percent in the period to end June 2001. On the other hand, the weighted average interest rate on commercial bank deposits rose to 4.51 percent from 4.45 percent, reducing the commercial banks' interest rate spread to 7.12 percent from 7.22 percent.

Bank and non-bank credit to the private sector continued to grow in 2001/2002, but at a slower pace than in the previous financial year. After expanding 18.8 percent (on an annual average basis) in the financial year to end June 2001, the growth rate of bank credit to the private sector slowed down to 14.9 percent in the financial year to end June 2002. Similarly, for non-bank financial institutions, the annual growth rate of credit to the private sector was reduced to 1.1 percent in 2001/2002 compared with 5.4 percent in 2000/2001. In the event, the annual growth rate in total money supply (M2) fell to 7.6 percent in fiscal year 2001/2002 compared with a growth rate of 16.2 percent in the twelve months to end June 2001.

4. THE WORLD ECONOMY IN 2002/2003

Although the forecasts for the global economy in 2002 and 2003 were revised down slightly in August 2002, the outlook is still more positive than in the last financial year. In May 2002, the IMF forecast world growth to be around 2.8 percent in 2002 and 4.0 percent in 2003. However, given the unexpected weak recovery and emerging signs of an economic slowdown, the IMF's forecast for 2003 was revised down slightly to 3.7 percent.

Problems with the US economy are weighing very much on global growth prospects. The corporate scandals and weak equity markets in the US have dealt a blow to consumer and business confidence. And, the Federal Reserve is urging Americans to invest in local businesses to assist the US economy to grow. Growth in the Euro area and the UK has been slow, if not disappointing, which is why the European Central Bank and the Bank of England have not raised interest rates. A slowdown in the US economy would have a domino effect on Samoa's other main trading partners - Australia and New Zealand.

United States

The uncertainty surrounding the course of the US economy is threatening global growth. The Federal Reserve held US interest rates steady in August indicating that the economy's recovery from recession is less assured than in the first half of 2002. According to a Fed statement, the economy is at risk from the slowdown. A softening in aggregate demand that emerged recently has been prolonged by weakness in financial markets and problems related to corporate reporting. The IMF forecasts on US real growth in 2002 was lowered to 2.2 percent in August 2002 from 2.3 percent in May 2002 while growth for 2003 was lowered to 2.6 percent from 3.4 percent. If data for September and October 2002 come out negative, then the Fed is more likely to shift the bias of monetary policy towards easing.

Australia

It is forecast that the Australian economy will slowdown in the second half of 2002 and into the first half of 2003 on the back of problems in its farm sector and a slowdown in the demand for housing. The slowdown in the economy together with declining inflationary pressures will eliminate any need for the RBA to raise rates until a global recovery is underway. It is expected that the RBA will not raise rates further in 2002.

Global slowdown will also exert pressure on the Australian currency as the demand for Australian exports decline and commodity prices fall.

New Zealand

Negative sentiments in the world economy will hit New Zealand's growing economy. Export prices for New Zealand products are already down. The Reserve Bank has signaled that further rate rises in 2002 are now less likely than stated in its March 2002 Monetary Policy Statement.

Japan

The outlook for the Japanese economy has improved, with the IMF lowering the forecast contraction of that country's economy in 2002 from the 1.0 percent forecast in May 2002 to 0.5 percent in August 2002. The outlook for 2003 is also more positive with growth revised up from 0.8 percent to 1.0 percent. Although Japan's economy appears to have turned the corner, there are still risks to economic growth. The financial system still remains fragile so it would be premature to conclude that Japan's long-term economic future looks any brighter.

Europe

Growth in the Euro area has been very slow. So slow that the IMF has revised down real growth for the region in 2002 to 1.1 percent from its May 2002 forecast of 1.4 percent. Similarly, real growth for 2003 has been lowered to 2.5 percent from 2.9 percent. Any growth prospects for Euro land will be dampened by uncertainty in the US economic outlook.

In summary, the recovery of the global economy relies heavily on growth prospects for the US economy. With a cloud of uncertainty hanging over the path of the US economy, global recovery is also blurry. The month of July 2002 generated some negative numbers for the US economy and if more unfavourable data come out in September and October, there will be a shift from a position of 'balanced risks' to 'risks from a slowdown' in the economy. The IMF has revised its growth rate forecasts to reflect these recent developments in the world economy.

5. THE DOMESTIC ECONOMY IN 2002/2003

Economic activity looks set to expand in 2002/2003, boosted by the continuation of expansionary fiscal and monetary policies and the contemplated improvement (albeit slight) in world economic conditions. An overall Budget deficit has been approved for 2002/2003, financed mainly by external borrowing. Monetary policy will remain accommodative, enabling bank credit to the private sector to grow further. Agricultural production is expected to increase the supply of the main staple food items to the produce markets around the country. The expected growth in agricultural production and the reduction in tariffs on some imported items are expected to soften the impact on prices of the increased Value-added Goods and Services Tax (VAGST) rate from 10.0 percent to 12.5 percent. As a result, the annual rate of inflation is expected to decline towards the target rate of 3.0 percent in 2002/2003 from 7.4 percent in 2001/2002. On the external front, the strong growth in aggregate demand associated with the anticipated real growth in economic activity is expected to strengthen the demand for imports of goods and services. As a result, the balance of payments is likely to record an overall deficit in 2002/2003. This will reduce the level of international reserves although it should remain healthy, above the target level of 4.0 months of imports.

5.1 Government Budget 2002/2003

Fiscal policy in 2002/2003 remains expansionary with an expected overall Government Budget deficit of \$17.5 million, which is equivalent to 1.9 percent of GDP. This Budget deficit is slightly lower than the actual Budget deficit for 2001/2002. (See Table 3.)

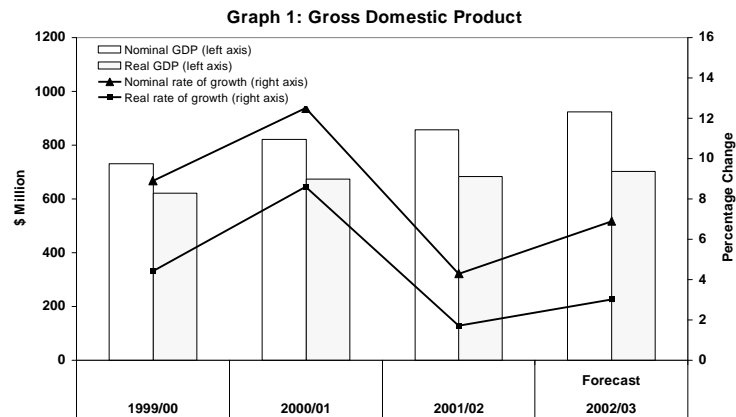
During the period	1999/00	2000/01	2001/02	2002/03 Forecast
Total Revenue and Grants	251.0	262.4	273.9	305.2
Total Revenue	194.4	197.3	198.7	231.0
Tax	156.7	174.8	182.7	206.5
Non-tax	37.7	22.5	16.0	24.5
External Grants	56.6	65.1	75.2	74.2
Total Expenditure	256.2	281.6	291.7	322.7
Current Expenditure	169.7	164.6	183.3	207.3
Development expenditure	67.1	103.1	87.3	103.8
Net Lending (1)	19.4	13.9	21.1	11.6
Overall surplus / Deficit (-)	-5.2	-19.2	-17.8	-17.5
Financing	5.2	19.2	17.8	17.5
External Financing	1.5	1.7	11.8	16.1
Disbursements	(10.4)	(13.3)	(23.9)	(29.6)
Amortisation	(-8.9)	(-11.6)	(-12.1)	(-13.5)
Domestic Financing	3.7	17.6	6.0	1.4
Monetary system	(3.2)	(12.0)	(-4.6)	(1.4)
Other	(0.5)	(5.6)	(10.6)	(-)

The 2002/2003 Government Budget follows much the same trend as that for the last financial year with the increase in total expenditures outstripping the growth in total revenue and grants. The resulting overall budget deficit, however, is consistent with the target set out in the Strategy For The Development of Samoa for 2002-2004. The deficit is also considered sustainable given that a large part of the expenditures are investment oriented. Education, health, agriculture and infrastructure feature prominently in the Budget. As part of Government's reform measures, the Budget provides for an increase in some taxes and reduction in others. On 1 October 2002, the VAGST rate will be raised from 10.0 percent to 12.5 percent whilst at the same time the tariff rates on imports that are currently subjected to a 10.0 percent duty will be reduced to 8.0 percent. This cover imported goods that are commonly used by households and includes most raw materials and capital equipment used by businesses. The 2002/2003 Budget also allows for further broadening of the income tax base by subjecting the 'commercial fishing' sector of the fishing industry to income tax. Other changes introduced by Government include increases on excise taxes on soft

drinks and alcoholic beverages, petroleum products and tobacco products and motor vehicle and licence fees.

5.2 Real Sector Outlook

After the surprisingly relatively low real growth in 2001/2002, the outlook for the Samoan economy in 2002/2003 is more positive. The Central Bank's macro-economic forecasts have targeted real GDP growth of around 3.0 percent in the fiscal year to June 2003 (from 1.7 percent in the fiscal year to June 2002). (See Graph 1.)



The main stimulus for growth in 2002/2003 is the expansionary Government Budget for the fiscal year to end June 2003. The overall Government Budget deficit is estimated at \$17.5 million, equivalent to 1.9 percent of nominal GDP. Furthermore, the continuation of a relaxed monetary policy will also facilitate real economic growth in 2002/2003. In this regard, the Central Bank's monetary policy settings will remain largely unchanged in 2002/2003. This would mean that the overall level of interest rates on Central Bank securities and on commercial bank deposits and credit would be maintained at their current levels. This should see bank credit to the private sector growing by 10.8 percent (on an

annual average basis) in 2002/2003 or 12.2 percent on an end-year-to-end-year basis.

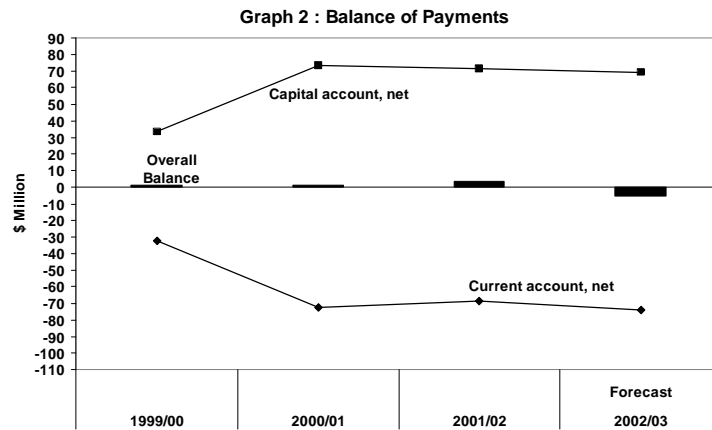
The anticipated growth in commercial bank credit to the private sector, the expected improvement in agriculture production and further growth in construction activity, are also expected to add to growth in 2002/2003. These, together with an expected strong growth in exports, tourism and private remittances (due to the anticipated improvement in world economic conditions) should see real GDP expanding in 2002/2003.

5.3 *Balance of Payments Outlook*

An overall deficit is expected in the balance of payments in 2002/2003 due mainly to the anticipated strong growth in aggregate demand and its consequent effect of expanding the total imports of goods and services. The total value of imports is anticipated to grow further in 2002/2003. After rising by 11 percent in the fiscal year to end June 2002, the total value of imports is expected to expand further by 7 percent in 2002/2003. Nevertheless, the expected expansion in imports will be moderated to some extent by the expected increases in exports, tourism and private remittances. (See Table 4 and Graph 2.)

During the period	1999/00	2000/01	2001/02	2002/03 Forecast
A. Current Account Balance	-32.2	-72.2	-68.4	-74.3
Merchandise Trade Balance	-261.1	-362.7	-410.2	-436.8
Exports	53.2	50.2	49.7	54.8
Imports	-314.2	-412.9	-459.9	-491.6
Services & income, net	96.3	140.8	163.9	175.9
Travel, net	117.8	128.4	145.8	162.5
Investment income, net	-4.8	-9.0	-5.8	-6.8
Other services, net	-16.7	21.3	23.9	20.2
Private remittances, net (1)	132.6	149.8	177.9	186.7
B. Capital Account Balance	33.6	73.6	71.8	69.2
Official grants, net	44.9	51.9	62.4	61.1
Official Loans, net	1.5	1.6	11.8	16.1
Government guaranteed loans, net	-15.9	-10.4	-9.9	-8.0
Private capital, net (2)	3.2	30.5	7.6	-
C. Overall Balance	1.4	1.4	2.3	-5.1

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

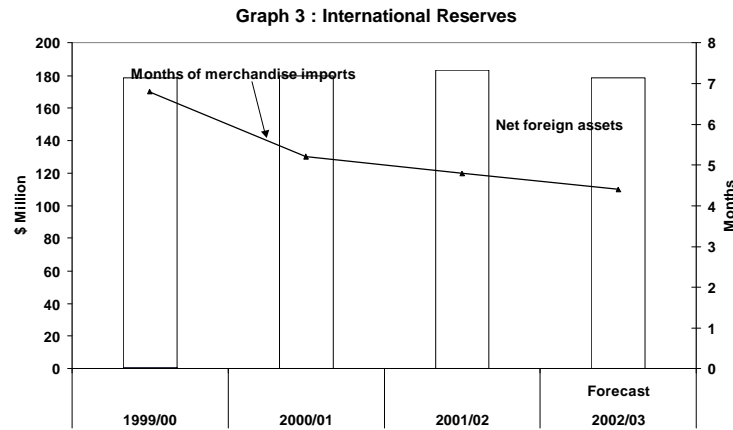


Total export earnings is expected to improve 10 percent in 2002/2003 after slipping 1 percent in 2001/2002. Much of the improvement is expected to come from increased earnings from fish, which is the main export commodity. With the world

economy starting to recover in 2002/2003, overseas demand is expected to pick up. The fishing industry is expected to benefit from this. The number of fishing vessels have grown and should continue to increase during the year, encouraged by the reduction of tariffs on fishing vessels. The positive impact of the increased size of the fishing fleet is expected to counter the potentially negative impact of the El Nino weather pattern on the average yield per boat. In addition to the expected improvement in revenues from fish exports, the resumption of coconut oil production, strengthening of the newly established desiccated coconut factory and increased demand for nonu products abroad are expected to bring in more foreign exchange earnings in 2002/2003. Export revenues from coconut cream and garments are not expected to change much from their levels in 2001/2002.

Tourism earnings and private remittances are expected to increase in 2002/2003, in line with the expected economic growth in the main source countries such as NZ, Australia and the US. On the capital account, the projected net inflow of external borrowings by Government is expected to ease some of the pressure on the balance of payments in 2002/2003.

All in all, an overall deficit of \$5.0 million in the balance of payments is expected in 2002/2003. As a result, the level of international reserves is forecast to slip from 4.8 months imports of goods at end June 2002 to 4.3 months in June 2003, largely reflecting the expected growth in imports. (See Graph 3.)

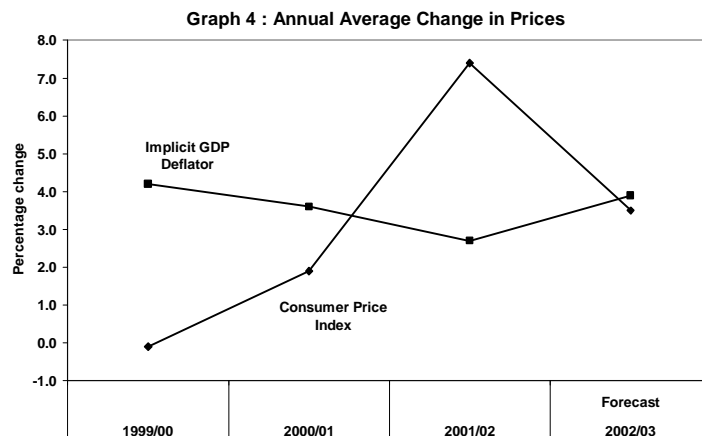


5.4 Inflation Outlook

The annual rate of inflation rose to 7.4 percent in 2001/2002 from 1.9 percent at the end of the previous financial year. It was also more than double the Central Bank's usual target of 3.0 percent but this was expected. The sharp rise in the rate of inflation was due mainly to a number of unavoidable significant factors. The local component of the CPI rose 10.5 percent in 2001/2002, the sharpest increase in the past eight years, due mainly to the upward revision in bus and taxi fares (July 2001), the dramatic rise in the prices of the main agricultural commodities and fish as a consequence of the very wet and windy weather conditions (in the eight months to June 2002) and the increased prices for beer and cigarettes (June 2002). The import component also went up by 3.8 percent, due mainly to the increased prices for petroleum products and inflation in source countries.

For 2002/2003, the upward pressure on prices will come mainly from the expected growth in domestic demand reflecting the growth in real incomes and the rise in the VAGST from 10.0 percent 12.5 percent. Offsetting some of these influences will be the expected expansion in supplies, particularly of agricultural commodities and the very low rate of inflation overseas. Thus, after increasing

dramatically in 2001/2002, the rise in the local component of the CPI is expected to fall to 3.0 percent. On the other hand, the import component, which will be entirely hit by the increase in the VAGST rate, is forecast to increase 4.1 percent. As a result, the overall rate of inflation is expected to decline to 3.5 percent around June 2003 from 7.4 percent at the end of June 2002. Similarly, the implicit GDP deflator, which represents the prices of all goods and services in the economy, is expected to rise by about 3.9 percent in 2002/2003. (See Graph 4.)



However, there is fear that a possible attack by the US on Iraq could see international petroleum prices soar again. We are optimistic, however, that this will not happen. We hope that dialogue will resume once again and that common sense will prevail.

6. MONETARY POLICY STANCE FOR 2002/2003

Contrary to expectations, the latest figures show that the economy grew by 1.7 percent in real terms in 2001/2002. (See Sub-section 3.2.) On the other hand, and as expected, the annual rate of inflation rose to 7.4 percent at end June 2002 and the level of reserves, as measured by the imports coverage ratio, declined but stayed above the minimum target level of 4.0 months.

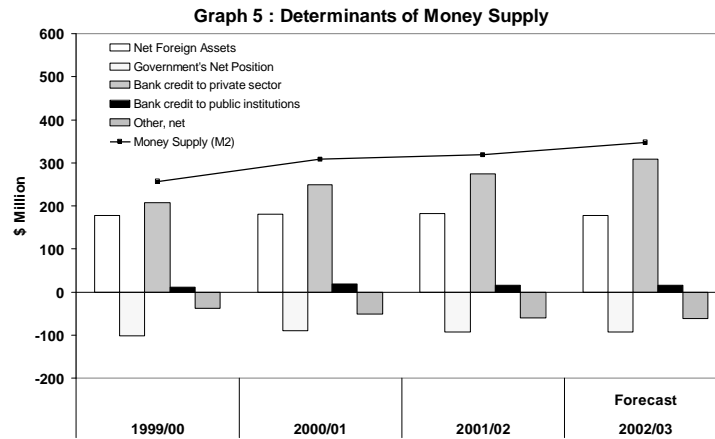
Macro-economic forecasts for 2002/2003 show a more comfortable expected outturn for inflation and Samoa's international reserves position. Agricultural production, which was adversely affected by unfavourable weather conditions between November 2001 and June 2002, is expected to improve in 2002/2003. This should see the supplies of the main roots, fruits and vegetables to produce markets around the country increase and their prices should decline as a result. The reduction in these prices and the reduction in the tariff rates on some imports are expected to offset some of the inflationary impact of the increased VAGST rate effective on 1 October 2002. As a result, the annual inflation rate is projected to decline to around 3.5 percent in June 2003 from 7.4 percent at the end of June 2002. Although the level of reserves is likely to decline, it should still remain above the target level of 4.0 months imports of goods.

Thus, the focus of monetary policy in the next twelve months would therefore be on growth, given that growth in 2001/2002 was disappointingly lower than expected. In 2002/2003, therefore, monetary policy will compliment fiscal policy in stimulating the economy into generating a higher real rate of growth of around 3.0 percent. To this end, monetary policy will remain accommodative during the financial year to end June 2003. The current thrust of the Central bank's open market operations will be maintained. In particular, the CBS will maintain the yields and the maturity structure of Central Bank securities issued at their current levels.

In this regard, the overall level of interest rates on CBS securities will be maintained at their current levels. In tandem with the expected trend in CBS securities interest rates, the interest rates on commercial bank deposits and credit are also expected to stay at their current levels.

As a result, bank credit to the private sector is expected to grow by 12.0 percent on an end-year on end-year basis compared with 9.9 percent in the previous financial year. Together with the expected reduction in Government's net deposits with the monetary system, the growth in private sector credit should see the growth rate of total money supply (M2) rise to 9.0 percent on an end-year on end-year basis (up from 3.6 percent at end June 2002). (See Table 5 and Graph 5.)

End of Period	1999/00	2000/01	2001/02	2002/03 Forecast
A. Determinants of Money Supply				
Net Foreign Assets	178.6	179.9	182.2	178.3
Net Domestic Assets	78.0	128.3	137.0	169.0
Government's Net Position	-101.5	-89.5	-93.0	-92.7
Bank credit to private sector	206.5	249.9	274.7	307.6
Bank credit to public institutions	11.9	17.8	15.2	15.2
Others, net	-38.8	-49.9	-59.9	-61.2
B. Money Supply (M2)				
Narrow Money	80.6	88.7	92.3	102.9
Currency Outside banks	22.6	23.3	26.1	31.0
Demand Deposits	58.0	65.3	66.2	71.9
Quasi-money	176.0	219.6	227.0	244.4
Savings deposits	36.5	40.4	45.5	52.0
Time deposits	124.0	156.6	171.4	178.4
Foreign Currency Deposits of Residents	15.4	22.7	10.1	14.0
Source: Central Bank of Samoa				



The expected deficit in the balance of payments would mean that the anticipated growth in bank credit to the private sector would be financed largely by banks running down their stocks of liquid assets, which are mainly held in CBS securities.

6.1 Open Market Operations and Interest Rates

Since the introduction of financial liberalization in January 1998, the Central Bank has been relying on the issuance of Central Bank Securities through Open Market Operations (OMO) to implement monetary policy. The Bank implements its intended monetary policy stance by influencing the level of liquidity in the financial system. It does this by conducting open market operations in Central Bank Securities. A more formal approach called Reserve Money Programming was introduced in November 2001 to forecast liquidity and determine the appropriate level of Central Bank Securities to be issued to influence the level of liquidity.

The Central Bank targets the commercial banks' exchange settlement account (ESA), that is, the banks' free reserves or deposits held with the Central Bank. In essence, OMO target a particular level for the commercial banks' ESA. If the liquidity

forecast show that the banks' ESA level would exceed the appropriate level for the ESA, the Bank will issue Securities to absorb the excess amount.

To further assist the commercial banks in managing their liquidity levels in the short term, a 14-day paper was introduced in January 2002, increasing to six the number of maturity options available to the public. The other maturities are the 28-days, 56-days, 91-days, 182-days and the 365-days. The range of options are, however, much wider since the securities could be traded based on their remaining days to maturity. The range, therefore, stretches from 1-day to 364-days.

Compared to June 2001, interest rates on Central Bank Securities, in particular 56 days, 91 days, 182 days and 365 days, increased at the end of June 2002. This trend continued in August as interest rates especially at the short end, climbed up slightly while rates at the long end of the spectrum have remained relatively stable.

In response to a liquidity shortage at the end of 2001, the Central Bank created two facilities through which commercial banks can borrow from the Central Bank on a short-term basis. The first one is called direct borrowing against collateral from the Central Bank. The second one is the repurchase agreement facility (repo) in which the CBS will buy back or repurchase the Securities already issued.

It is envisaged that once the money market in Samoa develops and deepens, the Central Bank will shift to using the interest rate to influence the level of liquidity in the banking 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 2002, the real effective exchange rate index rose 2.6 percent. This movement was mainly attributed to the larger increase in our inflation rate as compared to those of our major trading partners.

As a result of the currency basket review in August 2002, the number of currencies in the currency basket was reduced from 6 to 5. The basket now comprises the currencies of NZ, US, Australia, Fiji and Euro countries. The weightings were based on Samoa's distribution of trade, private remittances and travel transactions. Also, the current exchange rate program used in the calculation of the exchange rate was reviewed and modified for purposes of simplicity. This new program was adopted on 1 August 2002.

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. However, the Bank does not expect any substantial changes to the structure of trade in goods and services within the next twelve months.

6.3 *Foreign Exchange Regulations*

No changes were made to foreign exchange regulations since the beginning of the financial year 2000/2001, when the authority to approve current account payments was delegated to the commercial banks. On the payments side, no changes are envisaged for 2002/2003. On the receipts side, efforts are being made to ensure that foreign exchange earnings from current, financial and capital transactions are remitted to Samoa.

The Government has made a significant step towards encouraging the growth of exports through the introduction of the Government Export Guarantee Scheme (GEGS). The Scheme aims to boost exports by issuing Export Finance Guarantees (EFGs) as collateral to eligible exporters to obtain short-term finance (working capital) from the local commercial banks and the Development Bank of

Samoa to prepare confirmed export orders. In addition, the insurance policy requirement of the Scheme would strengthen the confidence of existing as well as new companies to produce new products for export as well as to export existing products to new lucrative markets overseas. This Scheme is very important to the development of exports given that the Enterprise Incentives Scheme has been abolished. As a start, an amount of SAT \$1.0 million was approved in the 2002/2003 Government Budget to back the guarantees that will be issued under the Scheme. The Scheme applies initially to the exports of goods only. Eventually, it is envisaged that as the GEGS Fund and Systems develop, the Scheme will be expanded to cover the exports of services as well.

The Scheme was designed in consultation with various stakeholders including the commercial banks, insurance companies and exporters in a series of meetings early in 2002. The Department of Trade Commerce and Industry is responsible for the day-to-day implementation of the Scheme while the GEGS Fund Account is held at and managed by the Central Bank.
