IMF Country Report No. 12/250

SAMOA

2012 ARTICLE IV CONSULTATION

August 2012

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2012 Article IV consultation with Samoa, the following documents have been released and are included in this package:

- **Staff Report** for the 2012 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on April 20, 2012, with the officials of Samoa on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 1, 2012. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Informational Annex** prepared by the IMF.
- **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- **Public Information Notice** (PIN)summarizing the views of the Executive Board as expressed during its June 15, 2012 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Samoa.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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SAMOA

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

June 1, 2012

KEY ISSUES

Samoa's economic growth has been slow and volatile over the past five years as a result of a series of shocks. Over the medium term, growth is projected to rise to around 2½ percent, a rate still significantly lower than what Samoa achieved in the decade before the current slowdown. This outlook is also subject to considerable downside risks in the current global, regional and domestic environment.

A key challenge is to reduce the fiscal deficit to bring public debt to a more sustainable level while supporting economic recovery. Meeting this challenge will require reprioritization of development expenditure and restraint on recurrent expenditure, including government wages and salaries. It is important that a medium-term consolidation path is spelled out and that borrowing decisions are made consistent with this path. Moreover, debt incurred by public enterprises needs to be closely monitored to ensure that contingent liabilities are manageable.

An appropriate mix of exchange rate and monetary policies is essential to maintain internal and external balances. Given the substantial real appreciation of the tala over the past decade, it is critical to monitor changes in Samoa's competitiveness and realign the exchange rate as necessary. Monetary policy, while appropriate to support recovery at the moment, should stand ready for tightening if and when the exchange rate begins to adjust.

Continued structural reforms are essential to restore Samoa's strong growth record. Much progress has been made, but considerable challenges remain. Priority should be given to reforming public enterprises, tapping the productive potential of customary land, strengthening financial supervision and intermediation, and further improving public financial management.

Approved By
Masato Miyazaki and Taline Koranchelian

Discussions were held with the authorities in Apia, Samoa during April 10-20, 2012. The team comprised Yongzheng Yang (mission chief and resident representative), Masahiko Kataoka, Shiu Raj Singh and Dechen Tshering (all APD) as well as Lai Tora and Caroline Currie (both ADB). Chris Becker (OED) participated in discussions.

CONTENTS

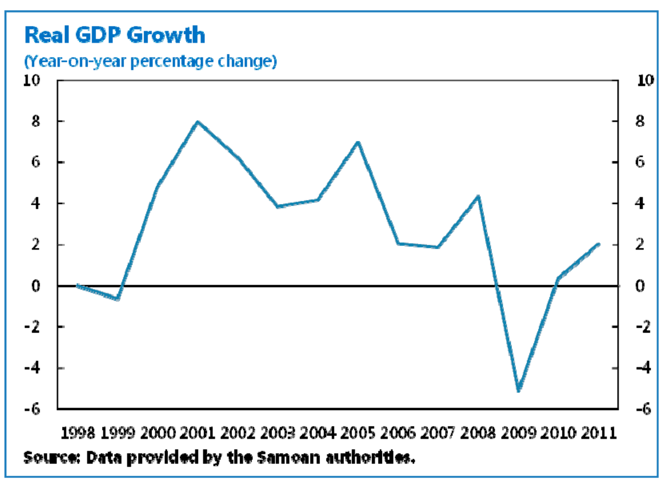
CONTEXT

1. **Samoa is heavily dependent on tourism, remittances, and aid**. It has a strong track record on macroeconomic management and until recently its economy had been growing more rapidly than most other Pacific island countries. The last Article IV consultation with Samoa was held in March 2010, following a delay in the aftermath of a devastating tsunami hitting the country in September 2009. A request for disbursement under the Rapid-Access Component of the Exogenous Shocks Facility was approved in December 2009. With the help of development partners, post-tsunami reconstruction is now almost complete. A general election was held in March 2011 and the incumbent government was returned to power.

2. **After a moderate recovery in 2010/11, the economy has shown signs of slowing down amid rising and volatile inflation caused by weather conditions.** Fiscal deficits and public debt have increased sharply in the wake of the global financial crisis and post-tsunami reconstruction, while the current account deficit has widened with the real appreciation of the tala. Foreign reserves have fallen significantly over the past year, but remain adequate. Banks are well capitalized and mostly profitable, but non-performing loans (NPLs) are rising for some banks amid weak economic activity, especially in the tourism industry.

RECENT DEVELOPMENTS AND OUTLOOK

3. **After two consecutive years of contraction, real GDP expanded by 2.0 percent in 2010/11 (July/June), on account of fiscal and monetary stimulus as well as swift post-tsunami reconstruction.** However, growth slowed considerably in the last quarter of 2011, to 0.8 percent (year-on-year), and is expected to remain subdued until the second quarter of 2012, when the celebration of the 50th anniversary of Samoa's independence will attract more tourists and boost economic activity. Growth is likely to be around 1½ percent

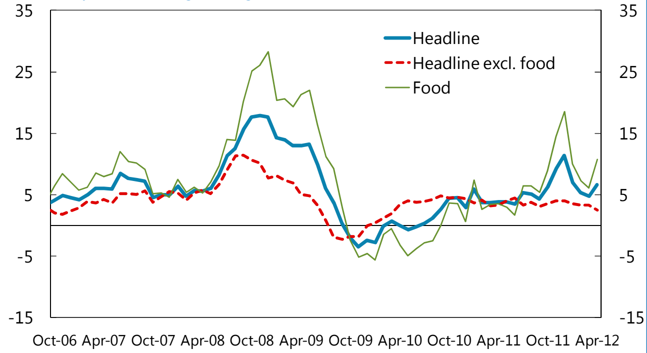


for FY2012 as a whole and to pick up pace only modestly in FY2013, as reconstruction activity continues to subside and the growth of external demand remains moderate. Over the medium term, growth is projected to rise to around 2½ percent. However, this outlook is subject to considerable downside risks given the uncertainties facing the global and regional economies and the domestic policy environment (see the section on managing risks).

4. **Inflation has been rising and volatile in recent months largely as a result of weather conditions that have affected the supply of agricultural products.** After peaking at 11.4 percent (4 percent excluding food) in December 2011, headline inflation fell back to 4.7 percent in March but accelerated again in April to 6.7 percent. Inflation is expected to be around 6 percent (yoy) by end-June, leaving the annual average rate at about 6½ percent for FY2012. Global food and fuel prices are projected to trend downward over the medium term, offering some relief on inflation.

CPI Inflation

(Year-on-year percentage change)

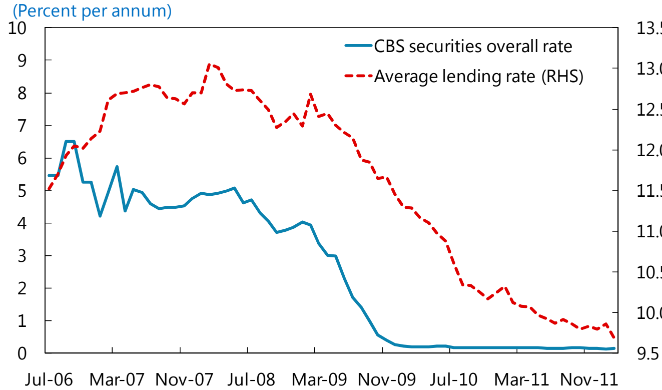


Source: Data provided by the Samoan authorities.

5. **The Central Bank of Samoa (CBS) has maintained an accommodative monetary policy to support economic activity since the global financial crisis.** Official interest rates are close to zero and the CBS has recently increased direct lending to the Development Bank of Samoa and the Samoa Housing Corporation, both of which on-lend to the private sector at interest rates lower than commercial banks charge. Banking sector liquidity has tightened considerably following recent dividend repatriation, outbound FDI and large one-off imports. The diversion of deposits from commercial banks to the newly established Unit Trust of Samoa (UTOS) has also contributed to the tightening liquidity situation in some banks.

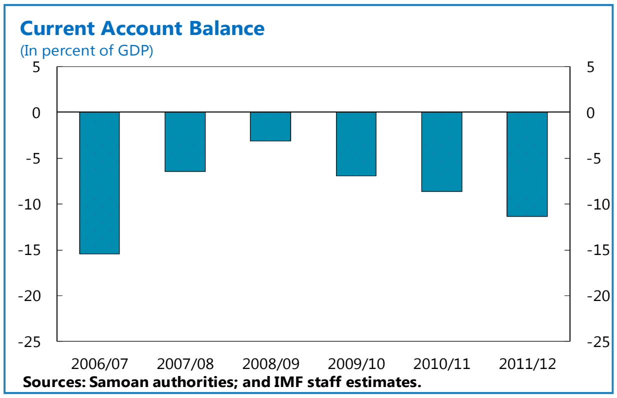
Interest Rates

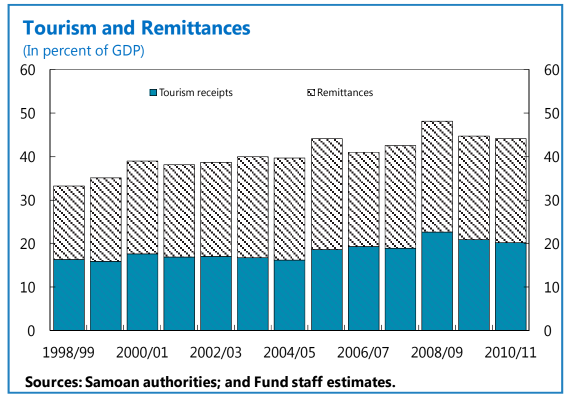
(Percent per annum)



Source: Data provided by the Samoan authorities.

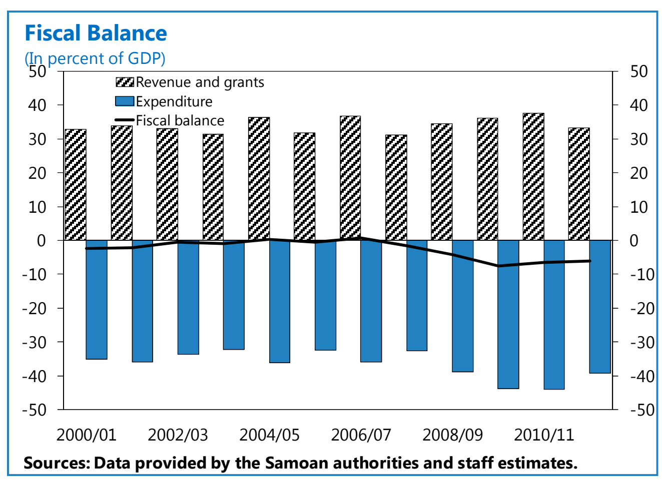
6. **The current account deficit has widened sharply over the past three years.** This has resulted from increased imports for post-tsunami reconstruction, rising world food and fuel prices,





and the slow recovery of remittances and tourism. As reconstruction activity winds down, however, the current account deficit is expected to trend downward over the medium term. Foreign reserves have declined sharply over the past year, to about US$151 million (about 4.3 months of next year's imports) at end March, following some large one-off imports, profit repatriation by banks, and outbound investment. While the tala's nominal effective exchange rate (NEER) has been stable in recent years, its real effective exchange rate (REER) has appreciated considerably as a result of inflation differentials with trading partners.

7. **The fiscal deficit has fallen gradually after increasing to 7½ of GDP in 2009/10 to support post-tsunami reconstruction.** The implementation of the 2011/12 budget is broadly on target, but supplementary appropriations will likely result in a fiscal deficit of 6 percent of GDP, about ½ percent of GDP higher than originally budgeted and only slightly lower than the level achieved last year. Revenue collection at end-March 2012 was slightly below pro rata projections as a result of lower-than-expected imports and a delay in increasing excises. Expenditure has also been broadly in line with budget projections, with possible savings on recurrent expenditure.



8. **The authorities agreed that the Samoan economy has slowed down and has not responded to the fiscal and monetary stimuli as anticipated.** Their growth forecast for the current fiscal year was slightly lower than staff's projection, but they expect a long-term growth rate

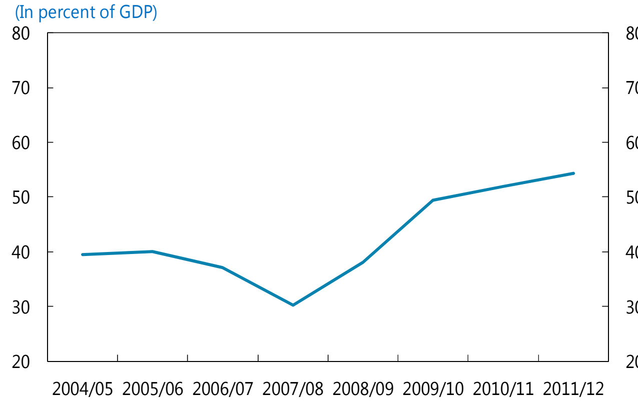
of 3 percent, slightly more optimistic than staff's forecast. The authorities' inflation forecast for FY2012 was similar to the staff forecast. The authorities agreed that the current account deficit has been high but noted that the imports were related to reconstruction activity. They emphasized that the foreign reserve level was still higher than the pre-tsunami level despite the sharp decline over the past year.

ENSURING INTERNAL AND EXTERNAL BALANCES

9. **Rising public debt calls for fiscal consolidation, particularly now that post-tsunami reconstruction is almost over.** An updated joint IMF-World Bank debt sustainability analysis suggests that Samoa's debt distress risk has risen from a low to moderate level, increasing the urgency for fiscal consolidation. However, a precipitous withdrawal of fiscal stimulus could put further strain on the weak domestic economic activity. Given this, staff advised steady reductions in the fiscal deficit in the near term, bringing it down to about 4½ percent of GDP in 2012/13 and 3½ percent in 2013/14. The deficit should be further reduced to 2½ percent of GDP in 2014/15 and to about 1½ percent of GDP in the long run. This, based on the debt sustainability analysis, would stabilize central government debt at 46 percent of GDP in present value (PV) terms in 2016/17 and reduce it to 40 percent of GDP in 2025/26, a level that will give Samoa the needed policy buffer to mount a fiscal response in the event of shocks. Staff continued to consider it appropriate to target the PV of debt to GDP ratio at 40 percent given Samoa's large and stable remittances (some 20 percent of GDP), which help mitigate debt distress risks.

External Public Sector Debt

(In percent of GDP)



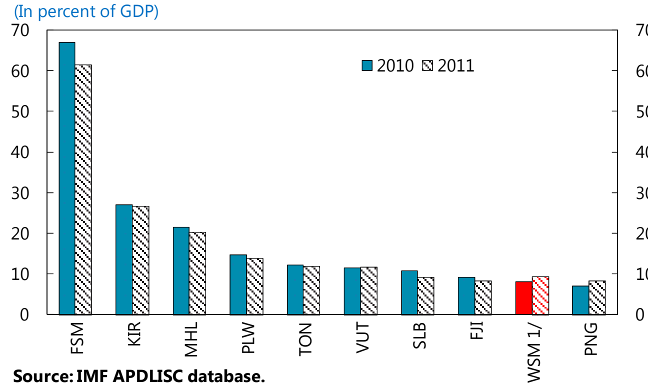
Source: Data provided by the Samoan authorities.

10. **It would be highly advisable that this debt target and the associated fiscal consolidation path are spelled out in the government's new medium-term fiscal strategy to increase its credibility and gain political support.** Further improvements in debt management, including better coordination with fiscal policy formulation, stronger adherence to procedures to contract debt, and improved efforts to contain the level of the government's contingent liabilities, would help achieve deficit and debt targets. The authorities reiterated their commitment to reducing

public debt to a more sustainable level over the medium term. They are currently projecting a fiscal deficit of 4–5 percent of GDP for FY2013 and plan to reduce it to below 3 percent by FY2015.

11. **Fiscal consolidation in 2012/13 will require rationalization of development projects, but current expenditure should also be restrained in order to maintain a relatively high level of public investment.** Over the past three years, development expenditure has more than doubled, reaching 18–19 percent of GDP in 2009/10 and 2010/11, before falling back to about 13½ percent in 2011/12. Just as the government reprioritized development expenditure as part of the post-tsunami reconstruction efforts, so does it need to re-examine its priorities in a post-tsunami era, particularly in line with the Strategy for the Development of Samoa. While it is important to budget adequate resources to maintain expanded infrastructure and improve service delivery in key areas such as health and education, further restraint on recurrent expenditure, including the public sector wage bill, would be important. Samoa's government wage bill has been one of the lowest in the region, but it has been rising over a number of years. The hiving off of agency employees from the central payroll led to some reductions in more recent years but these savings have moved to operating grants provided to these agencies. The authorities were cognizant of the recent increases in the government wage bill and planned to initiate a functional and structural review of the public service sector in FY2013 with a view to reduce duplication and overlap in government ministries and to strengthen the focus on core government functions. Staff advised that as the public service sector is streamlined, efforts should also be made to generate savings in other recurrent expenditure to ensure the attainment of the goals for medium-term fiscal consolidation.

Central Government Wages and Salaries
(In percent of GDP)



Source: IMF APDLISC database.
1/ In fiscal year July/June.

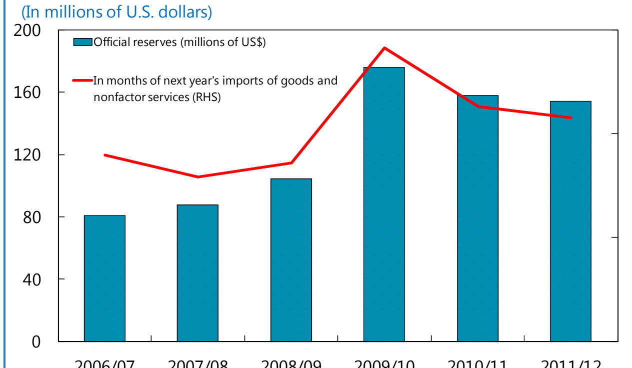
12. **The authorities indicated that they would take necessary actions to achieve this year's fiscal targets.** The Ministry of Revenue was confident that the revenue target would be met despite the weak economic activity. Samoa's recent accession to the World Trade Organization (WTO) is unlikely to have any major impact on revenue collection. Ministry officials indicated that they would build on the recent progress made under the Institutional Strengthening Program (ISP)—the compliance rate has reached 85 percent for both income tax and customs—and implement the second phase of the ISP with a focus on improvements in customs administration. They also advised

that further progress is being made with amendments to the Income Act and Tax Administration Act. The Ministry of Finance noted that given the uncertainty over revenue collection greater discretion would be exercised in authorizing spending—including a possible ban on non-externally funded travel—in order to meet this year's deficit target.

13. **It is critical that the government closely monitors debt incurred by public enterprises (PEs) and contain the risk they pose to public finance.** Although there appear to be no increase over time, total non-current PE debt is substantial, amounting to ST366 million at end-June 2010, of which ST54 million was in default and has been taken over by the government. At the end of 2011 the value of defaulted loans fell to ST45 million and other guaranteed outstanding loans amounted to ST60 million. Some 46 percent of term loans, which account for about 52 percent of non-current liabilities, are owed to commercial banks (about 11 percent of banks' 2011 loan portfolio), 14 percent to the Samoa National Provident Fund, 24 percent to the European Investment Bank, and the remaining 16 percent to the CBS and UTOS. The quality of loans extended by the Development Bank of Samoa has deteriorated sharply over the past 2 years, with NPLs now standing at 29 percent of total loans, up from 8 percent in June 2010. Near-to-medium term prospects for asset recovery do not look promising given the weak economic conditions. UTOS has the admirable objective of broadening investment opportunities for ordinary Samoans, but its current business model—attracting PE deposits away from commercial banks at higher interest rates to compensate for the shortage in individual investments and lending to other PEs at rates lower than bank rates—pose considerable fiscal risks as the government has guaranteed UTOS loans and agreed to underwrite some losses in the value of the shares the government continues to hold in privatized PEs and has transferred to UTOS. Moreover, the government has agreed to advance any amount to the Trust to pay its obligations, including the buyback of units should the Trust face cash flow constraints. The authorities were of the view that SOE financing operations of UTOS, with total assets of less than ST40 million, do not pose any additional fiscal risks and yet have increased competition in the credit market. Moreover, the authorities saw the benefits of rallying political support for PE reform with ordinary citizens sharing the profits earned from government-held shares in the privatized PEs.

14. **Exchange rate policy should continue to aim at protecting foreign reserves and ensure competitiveness of Samoan exports, including tourism.** As noted earlier, the decline in Samoa's reserves should slow down with continuous fiscal consolidation, but as debt repayments

Reserves
(In millions of U.S. dollars)



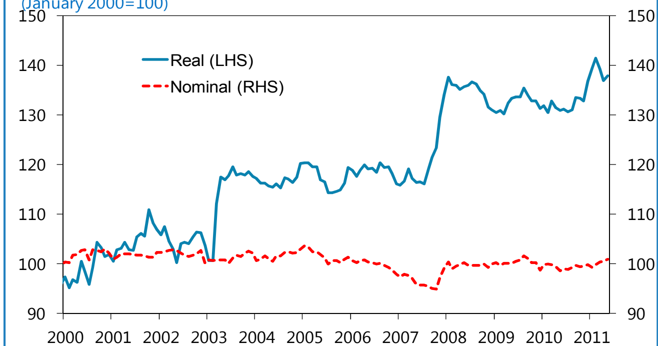
Sources: Samoan authorities; and IMF staff estimates.

increase, foreign reserves may come under pressure, especially if the recovery of remittances and tourism continues to be weak. The current level of reserves is close to the estimated optimal level of about 4½ months of current year imports, although this estimate is sensitive to the assumption of the opportunity cost of holding reserves (see Appendix I). The real appreciation of the tala may have also contributed importantly to the weak recovery of tourism, especially given increasing competition from some other Pacific island countries that have either devalued their currencies (e.g., Fiji) or use the weaker U.S. dollar as the legal tender (Palau).

15. **Standard exchange rate assessments suggest that the tala is overvalued by 11-25 percent (see Box 1).** Given this, a realignment of the exchange rate would be necessary and important for regaining Samoa's competitiveness, although its impact on inflation and debt dynamics should be carefully considered in the process. The authorities agreed that the REER was probably overvalued but saw the need for further technical assistance to determine the extent of overvaluation (especially by using alternative price indices in calculating the REER) and explore options to address the possible overvaluation. They also noted that the REER appreciation had often resulted from adverse terms of trade shocks (e.g., 2007/08 food and fuel price hikes) and as such its impact on competitiveness was not clear. The authorities took note of staff's view that declining agricultural production and slowing tourism growth in recent years may have, at least partly, resulted from reduced competitiveness as a result of exchange rate overvaluation. The authorities shared staff's view that the pegged exchange regime remains appropriate for Samoa given its underdeveloped financial market and high price pass-through, which would render excessive exchange rate volatility if the tala were floated.

Exchange Rates

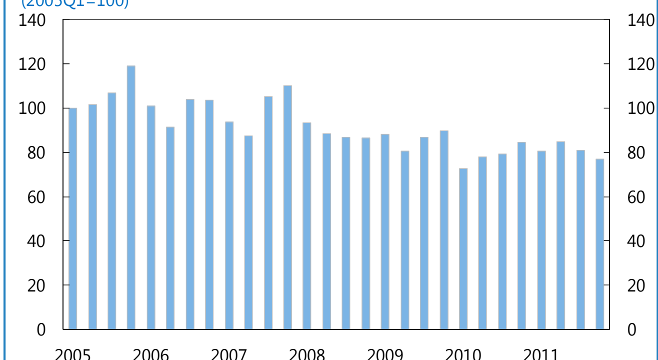
(January 2000=100)



Source: IMF, *Information Notice System.*

Agricultural Production

(2005Q1=100)

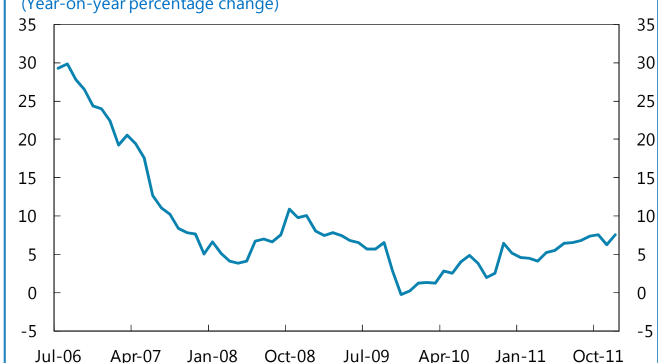


Sources: Data provided by the Samoan authorities and staff calculations.

16. **The staff would recommend a steady exchange rate realignment rather than a large step-devaluation, which is likely to be disruptive.** Specifically, the CBS could make use of the existing rules that allow the exchange rate to move by 2 percent without cabinet approval or restrictions on frequency. The exchange rate realignment could be accomplished over time through this flexibility. Such an adjustment would have a positive impact over time on growth, which would benefit from faster expansion of tourism and other exports, but the debt stock and service would rise significantly, as would inflation (see Box 2 for an illustration of such possible effects). An alternative to a nominal exchange rate realignment would be to tighten monetary policy to facilitate the required external adjustment and avoid excessive losses in reserves. This would likely lead to large output losses and put further strain on growth recovery. The authorities indicated that a gradual exchange rate adjustment would be feasible, but noted that it would not have much impact on exports due to the lack of supply response.

17. **Monetary policy can remain accommodative for the time being, but would need tightening should signs of underlying inflation pressure emerge or reserve losses continued.** Given the weak state of the economy and the declining trends of world commodity prices, there appears to be little underlying inflation pressure at present. However, CBS should stand ready to stamp out such pressure—especially in the context of a possible realignment of the exchange rate—and should tighten monetary policy in a pre-emptive manner given the weak monetary policy transmissions. In view of the high pass-through of exchange rate changes, a firm monetary policy is critical to avoiding the second-round effect on inflation of a realignment. Policy tightening should begin with increases in the policy rate and open market operations, and if necessary, complemented by hiking reserve requirements. While seeing the need to watch out for inflationary pressure and to tighten monetary policy in the event of an exchange rate adjustment, the authorities noted that the monetary policy should remain accommodative in the short run given the weak state of the economy.

Private Sector Credit Growth
(Year-on-year percentage change)



Source: Data provided by the Samoan authorities.

18. **Staff suggested there should be no further increase in the CBS Credit Line Facility.** The initial tranche appears to have helped rehabilitate the tourism industry following the tsunami. Given the recovery of credit growth since then and the fact the current financial difficulties with many small tourism operators appear to have largely resulted from weak external demand, any benefits of

further expanding the facility are likely to be outweighed by the risk it poses to the CBS balance sheet. Moreover, the facility could be converted into a fiscal operation, with an explicit budget allocation, to improve transparency regarding the fiscal implications of this support. To reduce the moral hazard problem, designated financial institutions for on-lending should share with the government the credit risk arising from the facility. Recent diversion of PE deposits to UTOS may have raised the funding costs for commercial banks and contributed to tight liquidity in some banks. As a result, pressures are building for interest rates to rise. CBS should closely monitor the situation, but there is no immediate need to systematically inject liquidity into banks.

MANAGING RISKS

19. **Risks to economic growth and stability in the short run stem primarily from Samoa's vulnerability to external shocks.** Sharp or protracted downturns in the global economy would pose serious challenges to the current efforts to strengthen recovery and maintain macroeconomic stability, as shown over the past few years (see the Risk Assessment Matrix below). The strength of the Australian, New Zealand and United States economies, which are Samoa's largest trading partners and main sources of remittances and tourist arrivals, are particularly important. Staff discussed with the authorities the options of policy response in the event of a severe external shock, including postponing fiscal consolidation, and, depending on the nature of the shock (falling demand or worsening terms of trade) and the inflation outlook, accelerated adjustment of the tala exchange rate to cushion the impact. Further monetary easing through open market operations and lowering reserve requirements could also be considered should bank liquidity tighten, although past experience has shown that the impact of such policies may be limited.

20. **Samoa is highly exposed to volatilities in global and domestic commodity prices, particularly given its heavy reliance on imported fuel and food.** Geopolitical uncertainties in the Middle East could lead to unexpected surges in fuel prices. Weather conditions, especially cyclones and extreme precipitations, could lead to large fluctuations in food prices, as occurred in 2004 and the second half of 2011. Price hikes could result in rapid deterioration in the current account deficit and rising inflation. Staff advised, and the authorities agreed, that Samoa should continue to allow full price pass-through should international prices surge again. However, monetary policy should be firm to prevent second-round effects of price surges. Moreover, Samoa should continue to rebuild policy buffers and improve the social safety net despite the cushion provided by the traditional community system.

SAMOA: RISK ASSESSMENT MATRIX

Nature/Source of Main Threats	Overall Level of Concern	
	Likelihood of Severe Realization of Threat in the Next 1–3 Years *(high, medium or low)*	**Expected Impact on Samoa if Threat is Realized** *(high, medium or low)*
Global "double-dip" recession that leads to a sharp slowdown in Australia, New Zealand and USA.	***Staff assessment: Low*** • The IMF WEO projections place a low probability on a double-dip recession. • Samoa would be exposed to a drop in tourist arrivals, remittances and demand for its exports. FDI may also be affected.	***Staff assessment: High*** • A severe shock like this could reduce GDP growth in Samoa by 1-2 percentage points and unemployment would rise. • Inflation is likely to fall as a global recession leads to lower commodity prices.
World commodity (especially food and fuel) price increases	***Staff assessment: Medium*** • Geopolitical uncertainty in the Middle East and parts of Asia is a non-negligible risk. • Samoa heavily relies on imports of food and fuel.	***Staff assessment: High*** • A 20 percent increase in food and fuel prices could increase the CPI by about 7 percentage points. • Current account deficit could widen by about 3 percent of GDP. • Samoa has good community-based social protection networks, so the impact on poverty would be small.
Continued exchange rate appreciation	***Staff assessment: Medium*** • Delays in actions to correct exchange rate misalignment because of the fear of inflation and the belief that exchange rate depreciation would not help exports.	***Staff assessment: Medium*** • Competitiveness would remain weak, leading to slow growth. • Trade balance would worsen and reserves would eventually fall to inadequate levels.

21. **Samoa also faces considerable risks to sustained growth and stability over the medium term.** The global financial crisis and the restructuring of the automobile industry in Australia seem to have led to a long-lasting, and possibly permanent, scale down of the Yazaki auto part plant, which has shed over 1,000 workers since the onset of the global financing crisis. The plant remains the largest private employer in the formal sector but its survival appears to depend entirely on a single car manufacturing plant in Australia (reduced from three). Recent efforts to expand exports into the Chinese market are encouraging, but it will take a while to yield significant results. The prospects for sustained growth of tourism hinge on the future development of the real exchange

rate as well as source country demand; further REER appreciation could dampen growth over the medium term. On the upside, Samoa could benefit from increased access to Australia's temporary workers scheme and receive more remittances. The recent accession to the WTO could also help improve investor confidence, though the impact is unlikely to be large.

RAISING LONG-TERM GROWTH

22. **Restoring Samoa's strong growth would require continued structural reforms.** Samoa undertook substantial reforms in the mid-1990s and these reforms had contributed to the strong growth prior to the current slowdown. However, the growth impact of these reforms seems to be tapering off. Continued fiscal consolidation would dampen aggregate demand, though with an imports-to-GDP ratio of 74 percent and even higher import content for public investment projects, the impact of reduced public spending would be moderate, particularly given the envisaged gradual consolidation. Samoa has been leading Pacific island countries in the World Bank's "doing business" indicators, but several countries are narrowing their gaps with Samoa. A recent report based on a conference organized by UNCTAD on Samoa's WTO accession suggests that there is considerable room for improvement. While an exchange rate realignment would help strengthen Samoa's competitiveness over time, the expected benefits would not be fully realized without simultaneous structural reforms to raise efficiency and alleviate supply constraints. Reforms would also ease the transition from government-driven recovery to a more broad based, private sector-led growth.

23. **Public enterprise reforms are a top priority.** Important progress has been made recently, including the privatization of Samoa Tel in January 2011 and the establishment of the Independent Selection Committee for directors of PE boards. Nevertheless, continued efforts will be needed as many public enterprises are performing poorly. The government recognizes the importance of improving the efficiency of PEs and has undertaken legal and corporate governance reforms to this end (see Box 3). The authorities plan to privatize three PEs in the next fiscal year.

24. **Considerable progress has been made in tapping customary land for productive use and further advances would be important to promote private investment.** As detailed in Box 4, important steps have been taken to update the institutional and legal framework for customary land, but the use of customary land as collateral for bank loans remains a key constraint on lending, discouraging private investment and restricting growth potential. Continued dialogue and consultation with land owners and the community at large to build consensus is critical to move the

reform forward. Staff welcomed the initiation of the third phase of customary land reforms supported by ADB advisory TA. While acknowledging the room for improvement, the authorities cautioned that the land issues could be easily exaggerated.

25. **Consolidation of recent achievements should be the focus of the continued effort to improve public financial management (PFM).** Staff welcomed the plan for the second phase of PFM reforms following a Public Expenditure and Financial Accountability (PEFA) assessment carried out in early 2010. The implementation of this plan would help develop sector plans for improved linkages to the budget, strengthen the budget process, procurement, and the accounting system, and improve tax administration as well as debt management and aid cooperation policy. To successfully implement this plan, Cabinet support to the plan would be critical and central agencies and line ministries would need to strengthen staff capacity to sustain the reform process.

26. **Continued reforms in the financial sector would be important in lifting growth and ensuring financial stability.** Staff welcomed the recent Cabinet approval of the proposed Personal Property Securities Act, which will allow moveable assets to be used as credit security, and looked forward to its early passage in Parliament. Similarly, establishing a credit bureau would help reduce credit risk and boost credit to the private sector. To ensure financial sector stability in an environment of rising NPLs for some banks, the CBS should strengthen bank supervision (especially on-site examinations) and be assigned the responsibility for supervising the UTOS and Samoa Housing Corporation (SHC). Staff also advised that UTOS should move away from subsidizing public enterprises through extending loans to them at below-market rates. This would also help generate higher returns for investors in the long run. As UTOS diversifies its investment into the private sector (including property markets) and foreign markets as envisaged, it needs to build its capacity for risk management. The authorities agreed with staff that CBS should supervise UTOS and SHC and step up its supervision efforts to ensure financial stability amid increasing financial difficulties in the private sector, particularly in tourism. The authorities saw the benefits of a credit bureau, but would rather leave it to banks to take the next step in establishing it.

27. **A review of Samoa's social safety schemes may be in order.** The Samoa National Pension Fund (NPF) is a defined contribution scheme. At present, almost all its members take lump-sum withdrawals rather than an annuity. Moreover, over 40 percent of members' contributions to the Fund have been taken out in member loans, significantly diminishing the role of the NPF in providing retirement incomes for members close to retirement at age 55. There is also a Senior Citizens Benefits Scheme for permanent residents aged 65 years and over and generous medical care provided by the government (full coverage of treatment and medication costs). In combination,

these schemes appear to have diminished incentives to save for retirement. As a result, there is likely to be an increase in the fiscal burden in the long run, especially as life expectancy increases and traditional family ties weaken over time with urbanization and migration. Staff saw a need to tighten the criteria for member loans and to undertake a review of the various schemes. On the investment side, around 28 percent of NPF's investment consists of loans to poorly performing public enterprises. Although these are mostly guaranteed by the government, efforts to allow gradual portfolio diversification via greater investments overseas would help minimize exposure to financial and fiscal risk. The authorities noted that the full withdrawal option and its use are in line with cultural tradition in Samoa.

OTHER ISSUES

28. **Statistics.** Samoa's economic statistics are broadly adequate for surveillance. The country is one of the few in the Pacific that disseminate monthly and quarterly economic statistics through government websites. However, there are weaknesses in national accounts and balance of payments statistics. With technical assistance, including through PFTAC, considerable progress is being made in improving these statistics and the authorities are committed to continued efforts. Central government accounting is on cash basis. The authorities are currently receiving assistance from PFTAC in transition to the GFSM2001 format. GFSM2001 format data is expected to be available before the next staff visit.

STAFF APPRAISAL

29. **Samoa's economy continues to recover, albeit at a modest pace.** Real GDP growth is expected to be around 1½ percent for FY2012 and rise to about 2 percent in FY2013. The medium-term outlook points to a moderate growth rate of around 2½ percent, a step-down from Samoa's strong growth record prior to the current slowdown. Risk to growth is tilted to the downside in the short run, mainly as a result of uncertainty over the global economy and the outlook for regional trading partners and source countries of remittances and tourists.

30. **A series of shocks have changed Samoa's macroeconomic landscape, reducing substantially the country's fiscal and external buffers**. Public debt has risen sharply as a result of fiscal stimulus in the wake of the global financial crisis and a devastating tsunami. At the same time, monetary policy was eased and has remained accommodative ever since, and yet economic recovery remains weak and fragile. The current account balance has deteriorated sharply, but generous donor support has kept reserves at comfortable levels. The authorities should be commended for managing the difficult circumstances.

31. **However, decisive actions are now needed to reduce the fiscal deficit and bring public debt to a more sustainable level over the medium term.** Given the weak and fragile state of the recovery, however, fiscal consolidation should be measured and steady in the short run. It is highly advisable that a medium-term path for fiscal consolidation be spelled out with a corresponding debt management strategy to ensure appropriate levels of borrowings. Moreover, debt incurred by public enterprises should be closely monitored with improved statistics and their fiscal risks minimized.

32. **The authorities' fiscal plans for FY2013 are broadly appropriate.** However, to achieve a deficit target of 4-5 percent of GDP would require firm control over recurrent expenditure as well as reprioritization of development expenditure. Restraint on recurrent expenditure, including the public sector wage bill, will be important, not least to allow adequate resources to be devoted to the maintenance of expanded infrastructure and improvements in health and education services. Revenue efforts have been commendable and should continue.

33. **Samoa needs to examine its export competitiveness and adjusts its exchange rate as necessary**. The tala has appreciated substantially in real effective terms over the past decade and it is assessed to be overvalued. While the current level of reserves appears to be broadly adequate, a

steady realignment of the exchange rate may be necessary to prevent further reserve losses and strengthen export competitiveness, including in the tourism industry.

34. **Monetary policy stance can remain accommodative for the time being, but would need tightening when exchange rate adjustment takes place.** With the weak economic activity, there appears to be little underlying inflationary pressure at present. However, given the expected high price pass-through, CBS needs to stand ready to tighten the policy stance in order to prevent the second-round effect of an exchange rate realignment.

35. **Continued structural reforms would be vital to restore Samoa's strong growth record.** The current protracted growth downturn appears to reflect the diminishing benefits of the widely acclaimed reforms in the mid-1990s as well as real exchange rate appreciation and external shocks, which have dented Samoa's competitiveness. The authorities are encouraged to undertake bold reforms, focusing on raising the efficiency of public enterprises, further improving public financial management, making customary land more accessible for productive use, and deepening financial sector reforms.

36. **Managing risks should be part of the overall effort to ensure macroeconomic stability and sustained growth.** Given Samoa's vulnerability to exogenous shocks, it should continue to build policy buffers through determined efforts to consolidate its fiscal position and avoid delays in necessary adjustment to monetary and exchange rate policies.

37. It is recommended that the Article IV consultation continue on the current 24 month cycle with a staff visit in the next 12 months.

Box 1. Exchange Rate Assessment

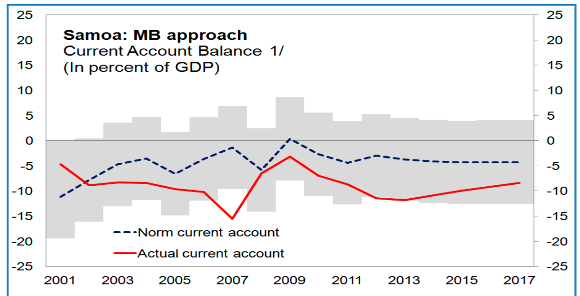
Three standard approaches have been applied to assess the value of the tala relative to its medium-term equilibrium level. The results show that the tala is likely to be about 11–25 percent above its equilibrium level.

Exchange Rate Assessment: Baseline Results 1/

	CA/GDP		REER
	Norm	Proj. 2/	Overvaluation
MB approach 3/	-4.3	-8.4	12.4 - 24.7
ERER approach 4/	…	…	16.8
ES approach 5/	-4.8	-8.4	10.9 - 21.7

Source: Fund staff estimates.
1/ All results are expressed in percent.
2/ Staff projection of the underlying CA/GDP in 2016/17.
3/ Based on a semi-elasticity bound of the CA/GDP with respect to the REER of -0.17 to -0.33.
4/ Overvaluation is assessed relative to December 2011.
5/ Current account deficit that stabilizes net foreign liabilities, estimated at 76 % of GDP over the medium term.

The Macroeconomic Balance (MB) approach suggests that Samoa's current account norm is about -4.3 percent of GDP. The decomposition of the fitted values into time-varying contributions shows economic growth, oil trade balance and aid inflows are the main factors in determining the norm. While Samoa's current account deficit is projected to gradually decline to 8.4 percent of GDP by 2016/17 with fiscal consolidation and the rebound of tourism and remittances from the impact of the global financial crisis and the tsunami, a gap is likely to remain, implying that the tala is overvalued by 12-25 percent based on a range of elasticities.

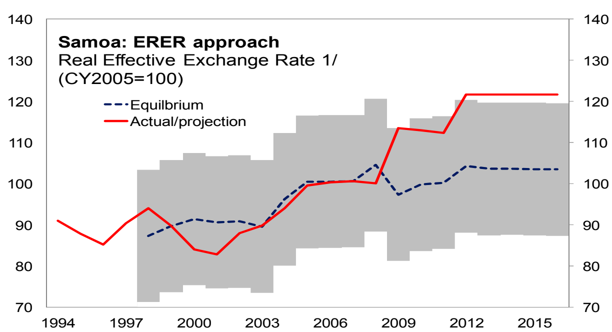


1/ The shaded area represents the 90 percent confidence interval.

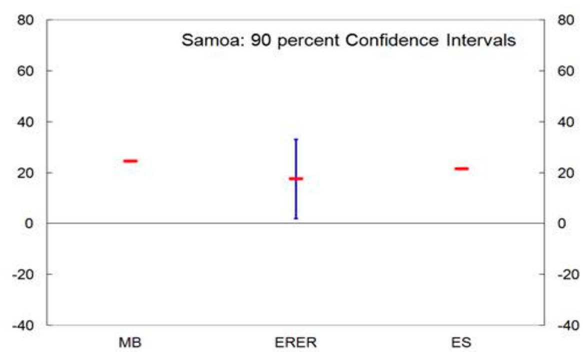
The Equilibrium Real Exchange Rate (ERER) approach shows that the tala is overvalued by about 17 percent. In this approach, key determinants of the equilibrium value are government consumption, labor productivity, aid inflows and terms of trade. The REER was around its equilibrium level in 2007/2008 but has since deviated from it rapidly, largely as a result of higher domestic inflation and nominal appreciation in 2008-09.

The External Stability (ES) approach, which estimates the current account norm that stabilizes net foreign assets at a targeted level, suggests the tala is overvalued by about 11–22 percent. The target for net foreign assets, at 76 percent of GDP, was derived from the current account balances during the period 2006/07–2008/09, which is considered to be broadly sustainable.

As with assessments for many other countries, the results presented here are subject to considerable uncertainty, mainly because small economies such as Samoa are volatile and their economic fundamentals can be altered by exogenous shocks.



1/ The shaded area represents the 90 percent confidence internal of the equilibrium.



Box 2. An Exchange Rate Adjustment Scenario

This box presents a scenario of gradual exchange realignment for Samoa. The advantage of such a gradual approach is that it allows time for businesses and consumers to adjust to changing economic circumstances and hence is less disruptive to economic activities. However, this approach could also invite one-way bids on exchange rate movements, although this risk is mitigated somewhat by the fact that Samoa's capital inflows are almost entirely in the forms of foreign direct investment and official grants and loans. In contrast, such risk could be avoided through a well-planned one-off surprise adjustment. The scenario is purely for illustration purposes.

Suppose that the real exchange rate adjustment needed is about 12 percent over two years. The target for nominal adjustment should be around 20 percent assuming inflation would rise by about 8 percentage points. This ballpark estimate of inflation impact assumes full price pass-through and is broadly in line with the fact that just over 40 percent of Samoa's CPI basket is imported. Given that a number of products are under price control, full price pass-through may not take place over two years and some price increases, say 2 percentage points, would spill over to the third year. Assuming baseline inflation is 4 percent and the exchange rate is adjusted by 10 percent each in FY2013 and FY2014, inflation would rise to 7 percent in these two years and to 6 percent in FY2015.

In addition to inflation, the exchange rate adjustment would have several effects on the Samoan economy. The resulting real appreciation would provide a boost to the tradables, such as tourism and agricultural products. At the same time, it would also reduce imports and encourage production of import substitutes. As a result, growth would likely increase and current account deficits decline over time, which would help raise levels of foreign reserves. It is also possible that foreign direct investment would also increase. The key to ensure such competitiveness gains is to exercise firm control on inflation through appropriately tight monetary policy. In the table to the right, it is also assumed that fiscal consolidation would be somewhat faster than in the baseline while the exchange rate is being adjusted, to lend support to monetary policy.

An Exchange Rate Adjustment Scenario, 2011/12-2016/17

Fiscal year	2012	2013	2014	2015	2016	2017
	(y/y percentage change)					
Real GDP growth	1.5	2.2	2.5	2.8	2.9	3.0
Change in CPI (avg.)	6.5	7.0	7.0	6.0	4.0	4.0
	(In percent of GDP)					
Revenue and grants	33.0	32.0	32.0	32.0	32.0	32.0
Expenditure	39.0	36.5	35.0	33.4	33.5	33.6
Overall balance	-6.0	-4.5	-3.0	-1.5	-1.5	-1.5
CA balance	-10.9	-9.0	-8.3	-6.1	-5.6	-5.5
External debt (PVs)	38.1	42.3	45.6	46.0	46.6	47.6
	(In months of next years imports)					
Gross reserves	4.3	4.5	4.7	5.1	5.4	5.7

One of the negative consequences of such an exchange rate adjustment is an increase in debt stock and service, as most of Samoa's public debt is external and denominated in foreign currencies. It is estimated that Samoa's external debt in PV terms could peak at about 48 percent of GDP in 2016/17 before falling back below 40 percent in 2023/24. This would mean that Samoa would remain at moderate level of debt distress risk as in the baseline.

Box 3. Improving the efficiency of Public Enterprises

Public enterprises (PEs) make up a significant proportion of Samoa's economy—there are 28 PEs (17 public trading bodies, 3 public mutual bodies and 8 public beneficial bodies) which are mandated to deliver services to the public. From a budgetary perspective, satisfactory financial performance of these enterprises is crucial because their profits are needed to service the capital (loan or equity) provided by the government. From an economic perspective, generation of income and paying dividends by public enterprises is critical to ensure that capital is not locked up in low-productivity activities and depleted over time. Many public enterprises are, however, performing poorly.

The government is committed to improving the quality and strengthening the impact of performance monitoring of the PEs. The Ministry of Finance is responsible for ensuring that PEs conform to the Public Bodies Act (2001) and monitors their performance and accountability standards. All PEs are mandated by law to operate as successful businesses, and obligated by the Ministry of Finance to generate a return on equity of 7 percent. However, during the 8-year period 2002-2010, the 15 commercial PEs returned only 0.3 percent on equity and 0.2 percent on average assets of over 850 million tala.

The government recognizes the importance of improving PE efficiency and has undertaken legal and corporate governance reforms to this end. The passage of the Composition Act in early 2012 is an important milestone for PE reform. The Act has paved the way for the appointment of 180 board directors (many of them are new to PE boards) and the removal of ex-officio directors from all PE boards, with the exception of the Development Bank of Samoa and the National Provident Fund. This process, which is expected to have been completed by end April 2012, will allow the boards of the PEs to operate more independently of political influence and in so doing become more accountable for their performance.

The pace of reform is picking up. Following the successful privatization of Samoa Tel, the government is committed to continuing the privatization of non-strategic PEs including the Trust Estate Corporation, the Agricultural Store Corporation and the Samoa Shipping Services. Successful reforms in the PE sector are pivotal to the overall economic reform process in Samoa. The government has requested technical assistance from the ADB to progress these reforms.

Box 4. Promoting Economic Use of Customary Land

Customary land is probably Samoa's most important natural resource, but it is far from being fully utilized. Large areas remain underdeveloped despite many years of efforts. Many aspects of customary land are enshrined in law such as the Constitution of the Independent State of Samoa, the Alienation of Customary Land Act 1965, Taking of Lands Act 1964, and the Village Fono Act 1984. The legal boundaries of customary land vested in Samoan family titles are not always clearly defined and establishing clear title to the land is costly and time consuming. A key challenge is how to make customary land available as security for bank loans to allow for its development for the benefit of owners and investors alike. Sharing the rewards and benefits from leasing and licensing of customary land is a central plank in recent customary land reforms.

The government has made considerable progress in instigating customary land reforms. For example, the Land Title Registration Act 2009 (replacing the Land and Titles Act 1981) was implemented on 31 March 2010; the land Registry is now fully computerized; a Customary Land Advisory Commission was established; and the Customary Land Leasing Section within the Lands Division of the Ministry of National Resources and Environment has been set up. Changes to customary land legislation have also been supported to streamline processes and procedures to lease customary land.

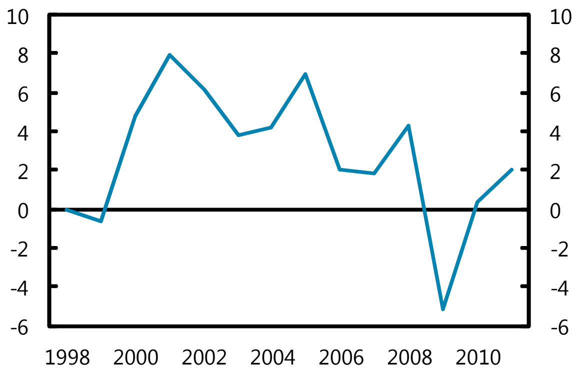
Despite these efforts, much remains to be done in promoting the economic use of customary land. The use of customary land as collateral for bank loans remains one of the biggest impediments to lending. The multiple ownership structure of the land and the sensitivity surrounding ownership and use of land, combined with the fact that much of customary land in its current status has little marketable value, means that banks remain cautious with respect to accepting customary land as security against business loans. This has also possibly contributed to higher demand for loans from the provident fund for which pension savings are used as collateral.

The reform process is ongoing and further progress will require much extensive consultation in view of the sensitivity of the issues involved. Given the government's policy not to alienate customary land, the key task ahead is to build consensus on a legal framework and acceptable commercial practices and processes that would open up investment, possibly through leases that are bankable and transferable without affecting communal ownership. In this regard, ongoing dialogue and consultation with land owners and the community at large to build consensus will be a critical aspect of the reform. This is a complicated and costly process that could take years before it bears fruits. Capacity constraints (for example, availability of legal professionals and land use specialists) could further impede the pace of the reform process. ADB is providing advisory technical assistance to support a third phase of Customary Land Reforms (US$900,000) to move the process forward.

Figure 1. Samoa: Economic Development

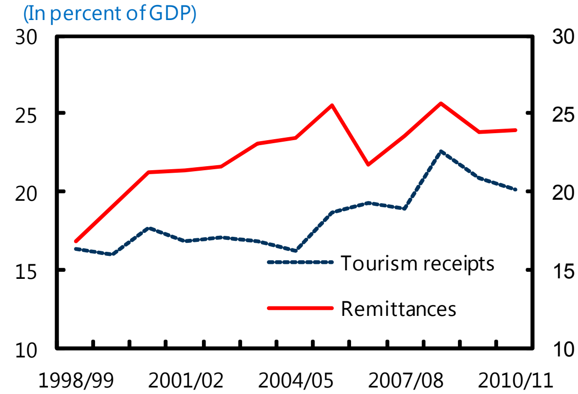
GDP growth has been slow and volatile...

Samoa: Real GDP Growth



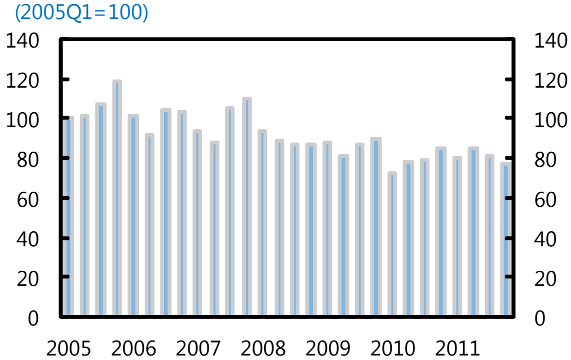
Contributions from tourism and remittances are declining....

Tourism and Remittances
(In percent of GDP)



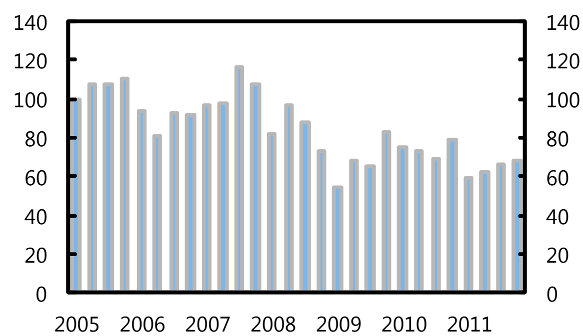
Agricultural output has declined significantly....

Samoa: Real GDP, Agricultural Production
(2005Q1=100)



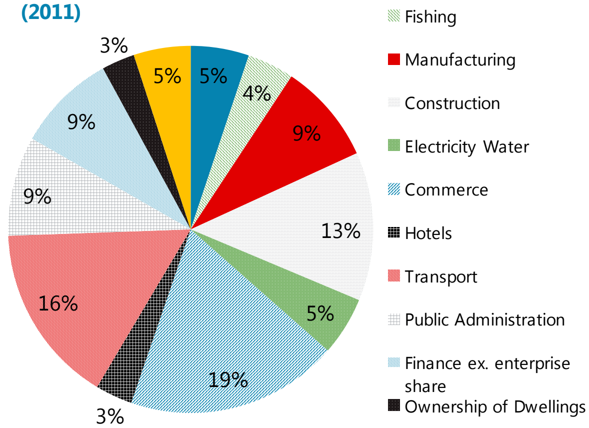
And so has manufacturing....

Samoa: Manufacturing



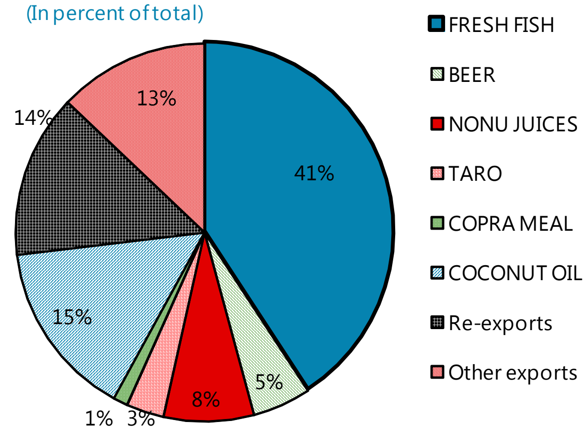
Tradeable sectors are relatively small....

Samoa: Composition of GDP (2011)



....and Exports are small and mostly primary products.

2011 Exports Composition
(In percent of total)

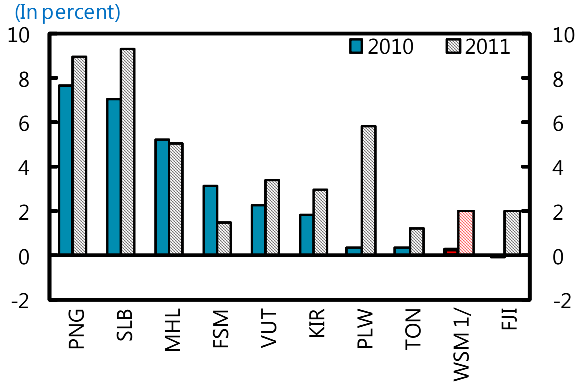


Sources: Samoan authorities and staff calculations

Figure 2. Samoa: Relative Performance

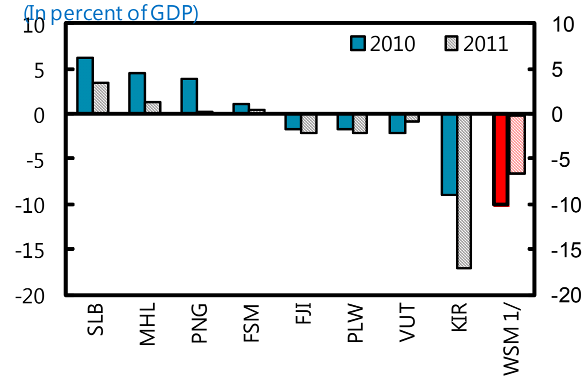
GDP growth is low compared to peers....

Real GDP Growth
(In percent)



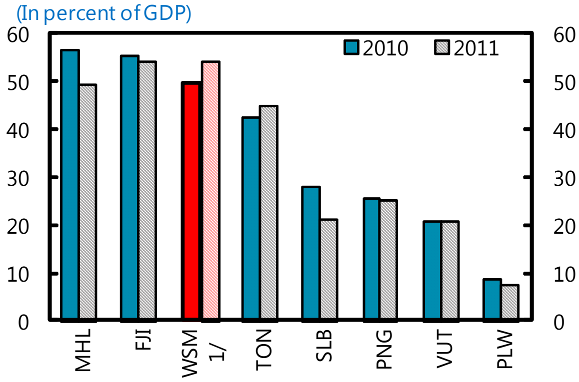
Fiscal deficit is relatively higher....

Fiscal Balance
(In percent of GDP)



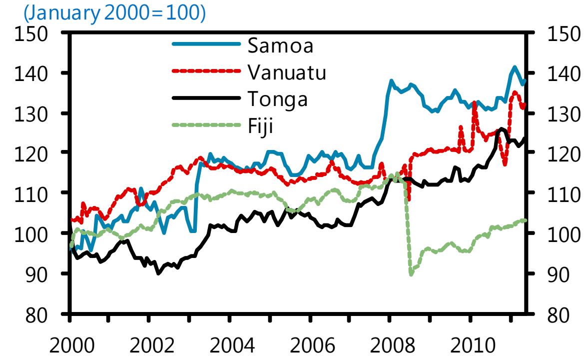
Debt level is high and rising....

Central Government Debt
(In percent of GDP)



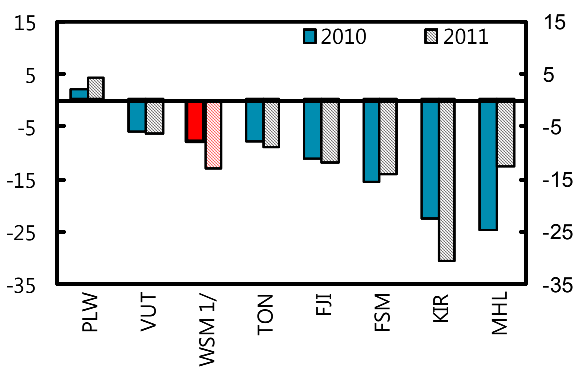
REER has appreciated substantially....

Real Effective Exchange Rates
(January 2000=100)



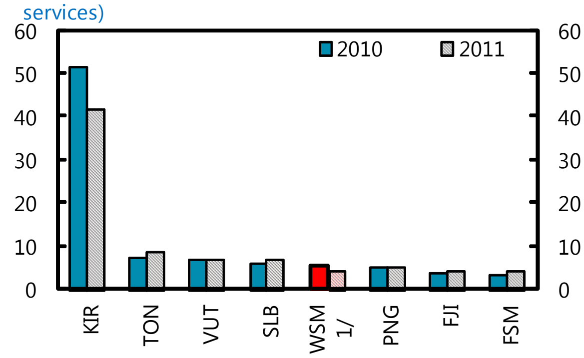
Current account deficit is rising....

Current Account Balance
(In percent of GDP)



.... and foreign reserves are declining.

Gross Official Reserves
(In months of next year's imports of goods and nonfactor services)



Sources: IMF's APD LISC and INS Databases
Samoa's data is in fiscal year July/June

Table 1. Samoa: Selected Economic and Financial Indicators, 2006/07–2012/13 /1

Population (2008): 0.18 million
Main Exports: Tourism, Fish
GDP per capita (2010/11): US$ 3,472
Quota: SDR 11.6 million

	2006/07	2007/08	2008/09	2009/10	2010/11 Est.	Proj. 2011/12	Proj. 2012/13
	(12-month percent change)						
Output and inflation							
Real GDP growth	1.8	4.3	-5.1	0.4	2.0	1.5	1.9
Nominal GDP	9.0	9.7	-2.3	1.9	4.3	8.1	3.9
Change in CPI (end period)	8.0	8.9	10.0	-0.3	2.9	6.0	4.0
Change in CPI (period average)	4.7	6.3	14.6	-0.2	2.9	6.5	2.0
	(In percent of GDP)						
Central government budget							
Revenue and grants	36.6	31.2	34.5	36.2	37.5	33.0	31.9
Of which: grants	7.4	5.3	7.8	10.5	9.5	8.1	7.1
Expenditure and net lending	36.0	32.7	38.8	43.6	43.9	39.0	37.0
Of which: Development	9.3	6.6	12.8	18.9	18.0	13.4	12.9
Overall balance	0.6	-1.5	-4.2	-7.5	-6.4	-6.0	-5.0
External financing	-1.1	0.9	3.1	10.0	5.5	6.8	5.5
Domestic financing	0.4	0.6	1.1	-2.5	1.0	-0.8	-0.5
	(12-month percent change)						
Money and credit							
Broad money (M2)	8.7	14.5	7.7	10.9	-0.8	-2.4	…
Net foreign assets	9.0	14.4	9.2	32.7	-11.6	-7.6	…
Net domestic assets	8.5	14.5	7.1	1.5	5.3	0.1	…
Private sector credit	12.7	6.7	6.5	4.0	6.4	6.2	…
	(In millions of U.S. dollars)						
Balance of payments							
Current account balance	-80.6	-32.6	-18.0	-45.0	-54.7	-81.5	-87.8
(In percent of GDP)	-15.5	-6.5	-3.1	-7.2	-8.6	-11.4	-11.8
Merchandise exports, f.o.b.	12.2	11.2	11.3	13.2	11.8	12.5	12.9
Merchandise imports, c.i.f.	-241.1	-204.3	-251.1	-278.2	-279.1	-331.9	-339.4
Services (net)	81.9	85.8	101.6	100.0	95.1	110.3	104.6
Income (net)	-37.5	-38.0	-19.0	-19.7	-30.1	-28.0	-29.0
Current transfers	103.9	112.8	139.3	139.8	147.7	155.7	163.2
External reserves and debt							
Gross official reserves	80.9	87.6	104.4	175.8	157.6	151.5	146.8
(In months of next year's imports of GNFS)	3.6	3.2	3.4	5.7	4.5	4.2	4.0
External debt (in percent of GDP)	37.1	30.3	45.3	53.6	49.3	53.2	57.1
Public external debt-service ratio (in percent of exports	5.2	3.9	5.1	2.4	3.8	4.5	7.0
Exchange rates							
Market rate (tala/U.S. dollar, period average)	2.6	2.6	2.7	2.3	2.3	…	…
Market rate (tala/U.S. dollar, end period)	2.6	2.9	2.5	2.4	2.3	…	…
Nominal effective exchange rate (2000 = 100) 2/	97.3	94.9	97.6	97.9	98.0	…	…
Real effective exchange rate (2000 = 100) 2/	101.0	105.6	116.1	111.6	112.5	…	…
Memorandum items:							
Nominal GDP (in millions of tala)	1,330	1,459	1,426	1,452	1514	1637	1701
Nominal GDP (in millions of U.S. dollars)	520	502	572	618	633	714	744
GDP per capita (U.S. dollars)	2,888	2,778	3,151	3,414	3,472	3,893	4,044

Sources: Data provided by the Samoan authorities and Fund staff estimates.

1/ Fiscal year beginning July 1.
2/ IMF, Information Notice System (calendar year).

Table 2. Samoa: Illustrative Medium-Term Baseline Scenario, 2006/07-2016/17

						Projections					
	2006/07	2007/08	2008/09	2009/10	2010/11 Est.	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Growth and inflation											
Real GDP growth	1.8	4.3	-5.1	0.4	2.0	1.5	1.9	2.3	2.5	2.6	2.5
CPI inflation (period average)	4.7	6.3	14.6	-0.2	2.9	6.5	2.0	4.0	4.0	4.0	4.0
					(In percent of GDP)						
Fiscal accounts											
Total revenue and grants	36.6	31.2	34.5	36.2	37.5	33.0	31.9	31.9	31.9	31.9	31.9
Total revenue	29.2	25.9	26.7	25.6	28.0	24.8	24.8	24.8	24.8	24.8	24.8
External grants	7.4	5.3	7.8	10.5	9.5	8.1	7.1	7.1	7.1	7.1	7.1
Total expenditure and net lending	36.0	32.7	38.8	43.6	43.9	39.0	37.0	35.9	34.8	34.4	34.5
Overall balance (including grants)	0.6	-1.5	-4.2	-7.5	-6.4	-6.0	-5.0	-4.0	-3.0	-2.5	-2.5
					(Annual percentage change)						
Monetary survey											
Broad money	8.7	14.5	7.7	10.9	-0.8	-2.4	…	…	…	…	…
Private sector credit 1/	12.7	6.7	6.5	4.0	6.4	6.2	…	…	…	…	…
					(In millions of U.S. dollars)						
Balance of payments											
Current account	-80.6	-32.6	-18.0	-45.0	-54.7	-81.5	-87.8	-82.6	-78.5	-74.4	-71.1
(In percent of GDP)	-15.5	-6.5	-3.1	-7.2	-8.6	-11.4	-11.8	-10.8	-9.9	-9.1	-8.4
Merchandise trade balance	-228.9	-193.2	-239.8	-265.0	-267.4	-319.4	-326.6	-335.0	-345.2	-356.2	-369.0
Exports, f.o.b.	12.2	11.2	11.3	13.2	11.8	12.5	12.9	13.2	13.5	13.8	14.1
(Annual percent change)	10.7	-8.7	1.1	17.3	-11.1	6.2	3.1	2.4	2.3	2.3	2.3
Imports, c.i.f.	-241.1	-204.3	-251.1	-278.2	-279.1	-331.9	-339.4	-348.2	-358.6	-370.0	-383.1
(Annual percent change)	17.8	-15.2	22.9	10.8	0.3	18.9	2.3	2.6	3.0	3.2	3.5
Services	81.9	85.8	101.6	100.0	95.1	110.3	104.6	114.5	125.0	136.2	148.3
Current transfers, net	103.9	112.8	139.3	139.8	147.7	155.7	163.2	168.0	172.9	177.9	183.1
External debt and reserves											
Gross external public debt (percent of GDP)	37.1	30.3	45.3	53.6	49.3	53.2	57.1	60.7	62.6	63.4	64.1
NPV of external public debt (percent of GDP)	…	…	…	…	36.7	39.2	41.7	44.0	45.2	45.6	45.9
External debt-service ratio 2/	5.2	3.9	5.1	2.4	3.8	4.5	7.0	7.6	8.4	8.8	8.4
Gross official reserves (millions of U.S. dollars)	80.9	87.6	104.4	175.8	157.6	151.5	146.8	147.3	143.6	135.7	128.8
(In months of next year's imports of GNFS)	3.6	3.2	3.4	5.7	4.5	4.2	4.0	3.9	3.6	3.3	3.1

Sources: Data provided by the Samoan authorities and Fund staff projecti

1/ Total credit growth (including credit extended by nonbank financial institutions).
2/ In percent of GNFS exports.

Table 3: Samoa: Balance of Payments, 2006/07–2012/13
(In million of U.S. dollars, unless otherwise indicated)

	2006/07	2007/08	2008/09	2009/10	2010/11 Est.	Projections 2011/12	2012/13
Current account	-80.6	-32.6	-18.0	-45.0	-54.7	-81.5	-87.8
Trade balance	-228.9	-193.2	-239.8	-265.0	-267.4	-319.4	-326.6
Exports, fob	12.2	11.2	11.3	13.2	11.8	12.5	12.9
Imports, cif	-241.1	-204.3	-251.1	-278.2	-279.1	-331.9	-339.4
Services	81.9	85.8	101.6	100.0	95.1	110.3	104.6
Investment income	-37.5	-38.0	-19.0	-19.7	-30.1	-28.0	-29.0
Current transfers	103.9	112.8	139.3	139.8	147.7	155.7	163.2
Official transfers	1.9	1.6	1.9	0.0	2.5	2.0	2.0
Private transfers	102.0	111.2	137.4	139.8	145.2	153.7	161.2
Capital account	49.1	21.0	40.2	86.8	59.8	49.7	47.2
Official	49.3	23.4	40.9	77.4	60.8	52.1	53.0
Private	-0.2	-2.4	-0.6	9.4	-1.0	-2.4	-5.8
Financial account	24.2	21.7	19.6	26.8	-22.4	38.2	36.0
Direct investment	31.4	4.0	9.2	1.1	9.4	-2.4	2.8
Portfolio investment	0.0	-0.2	0.4	-0.9	-1.9	-1.1	-0.5
Other investment	-7.2	17.8	10.0	26.6	-29.9	41.8	33.6
Assets	1.3	0.1	-7.1	-51.8	-25.5	-19.1	-1.9
Liabilities	-8.4	17.7	17.1	78.4	-4.4	60.9	35.5
Net errors and omissions	18.2	5.7	-41.2	-4.2	-0.9	-12.7	0.0
Overall balance	11.0	15.9	0.7	64.4	-18.1	-6.2	-4.6
Financing	-11.0	-16.5	-2.8	-55.4	18.1	6.2	4.6
Change in gross official reserves	-11.0	-16.5	-2.8	-64.4	18.1	6.2	4.6
Fund financing	0.0	0.0	0.0	9.0	0.0	0.0	0.0
Financing gap	0.0	0.6	2.2	-9.0	0.0	0.0	0.0
Memorandum Items:							
Gross official reserves (in million of U.S. dollars	80.9	87.6	104.4	175.8	157.6	151.5	146.8
(In months of prospective imports of GNFS)	3.6	3.2	3.4	5.7	4.5	4.2	4.0
Exports (annual percentage change)	10.7	-8.7	1.1	17.3	-11.1	6.2	3.1
Remittances (in percent of GDP) 1/	20.0	22.5	24.4	22.5	23.2	22.5	22.4
Tourism earningss (in percent of GDP) 2/	30.5	30.2	32.1	30.0	28.9	28.3	28.3
Visitor Arrivals (thousands)	122.0	122.0	129.0	128.2	129.1	127.8	130.4
Imports (annual percentage change)	17.8	-15.2	22.9	10.8	0.3	18.9	2.3
Current account balance (in percent of GDP)	-15.5	-6.5	-3.1	-7.2	-8.6	-11.4	-11.8

Sources: Data provided by the Samoan authorities and Fund staff estimates.

1/ Including other current transfers.

2/ Including other service credits.

Table 4. Samoa: Financial Operations of the Central Government, 2005/06–2010/11

	2006/07	2007/08	2008/09	2009/10	2010/11 Est.	Proj. 2011/12	Proj. 2012/13
			(In millions of tala)				
Total revenue and grants	486.7	454.9	492.0	525.2	567.2	539.8	543.3
Total revenue	388.3	378.0	381.4	372.4	423.8	406.5	422.2
Tax revenue	334.1	330.2	324.7	324.8	346.0	362.5	376.6
Nontax revenue	54.2	47.8	56.7	47.6	77.8	43.9	45.6
External grants	98.5	76.9	110.7	152.8	143.4	133.3	121.1
Privatisation Receipts							
Total expenditure and net lending	478.3	476.5	552.5	633.8	664.6	638.2	628.8
Current expenditure	333.6	372.4	358.8	349.1	374.8	411.2	394.8
Development expenditure	123.7	96.2	182.1	273.8	272.9	220.0	220.0
Net lending	21.1	7.8	11.7	10.9	16.8	7.0	14.0
Overall fiscal balance	8.4	-21.6	-60.5	-108.7	-97.4	-98.4	-85.4
Financing	-8.4	21.6	60.5	108.7	97.4	98.4	85.4
External financing, net	7.4	12.5	44.6	144.8	82.7	110.8	93.9
Disbursements	14.0	28.5	60.4	160.1	100.6	129.2	126.0
Amortization	6.6	16.0	15.8	15.3	17.9	18.4	32.1
Domestic financing, net	5.9	9.1	15.9	-36.2	14.7	-12.4	-8.5
Banking system	-4.5	11.9	2.2	-82.9	10.3	-12.4	-8.4
Other	10.5	-2.8	13.7	46.8	4.4	0.0	-0.1
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0
			(In percent of GDP)				
Total revenue and grants	36.6	31.2	34.5	36.2	37.5	33.0	31.9
Total revenue	29.2	25.9	26.7	25.6	28.0	24.8	24.8
Tax revenue	25.1	22.6	22.8	22.4	22.8	22.1	22.1
Nontax revenue	4.1	3.3	4.0	3.3	5.1	2.7	2.7
External grants	7.4	5.3	7.8	10.5	9.5	8.1	7.1
Total expenditure and net lending	36.0	32.7	38.8	43.6	43.9	39.0	37.0
Current expenditure	25.1	25.5	25.2	24.0	24.8	25.1	23.2
Development expenditure	9.3	6.6	12.8	18.9	18.0	13.4	12.9
Net lending	1.6	0.5	0.8	0.8	1.1	0.4	0.8
Overall fiscal balance	0.6	-1.5	-4.2	-7.5	-6.4	-6.0	-5.0
Overall balance (excluding grants)	-6.8	-6.8	-12.0	-18.0	-15.9	-14.2	-12.1
Financing	-0.6	1.5	4.2	7.5	6.4	6.0	5.0
External financing, net	-1.1	0.9	3.1	10.0	5.5	6.8	5.5
Disbursement	1.1	2.0	4.2	11.0	6.6	7.9	7.4
Amortization	0.5	1.1	1.1	1.1	1.2	1.1	1.9
Domestic financing, net	0.4	0.6	1.1	-2.5	1.0	-0.8	-0.5
Banking system	-0.3	0.8	0.2	-5.7	0.7	-0.8	-0.5
Other	0.8	-0.2	1.0	3.2	0.3	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:							
Debt Nominal Values	493	442	646	778	787	885	957
Nominal GDP (in millions of Tala)	1,330	1,459	1,426	1,452	1,514	1,637	1,701
Debt/GDP Ratio (in percent)	37.1	30.3	45.3	53.6	49.3	53.2	57.1

Sources: Data provided by the Samoan authorities and Fund staff estimates.

Table 5. Samoa: Financial Soundness Indicators, 2004-12 1/

	2004	2005	2006	2007	2008	2009	2010	2011	2012 2/
	(in percent)								
Loans to deposit ratio	84.1	93.8	107.4	104.8	104.5	96.4	96.3	105.8	106.9
Capital adequacy ratio	24.5	24.1	24.4	28.0	28.0	30.2	28.4	28.3	28.0
Return on assets	3.3	4.0	4.6	3.7	4.1	3.2	3.5	3.2	3.2
Non-performing loans ratio 3/	7.9	6.3	6.7	10.8	8.8	9.7	10.9	8.5	5.5
Net interest margins	9.0	8.7	8.3	7.0	7.5	7.2	8.0	9.4	8.0
Liquid assets to short-term liabilities	16.4	12.9	5.7	12.5	19.0	26.4	33.0	16.3	19.2
Bank provisions to non-performing loans 3/	51.9	52.3	43.2	31.5	48.0	53.7	34.3	49.0	83.5

Source: Central Bank of Samoa.

1/ For commercial banks.
2/ 2012 data are as of end-March.
3/ Three-months overdue and longer.

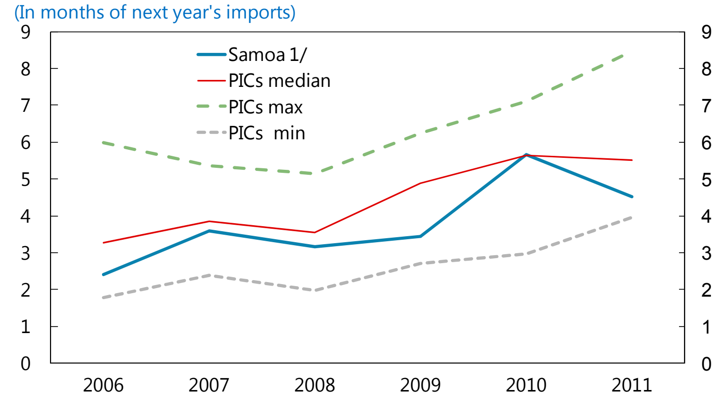
APPENDIX I: SAMOA—RESERVE ADEQUACY

Samoa's foreign reserves stood at US$151 million (about 4.3 months of next year's imports) as of end-March 2012. Although this amount is significantly lower than the level at end-June 2010 (US$175.8 million), it is still higher than the pre-tsunami level. Samoa's foreign reserves experienced an overall increase during 2006-08, reaching about US$123 million in September 2009. Reserves surged in the wake of the tsunami as a result of increased aid flows, an IMF SDR allocation, and a disbursement of emergency assistance under the Rapid-Access Component of the Fund's Exogenous Shocks Facility. The decline over the past year reflected the rising food and fuel prices, large one-off imports, profit repatriation by banks and outbound investment, as well as continued reconstruction activities, albeit on a declining scale. Sluggish recovery of remittances and tourism has also contributed to the decline in reserves. This trend is expected to continue due to increases in debt repayments and continuation of weak tourism and remittances.

Samoa's foreign reserves have been generally lower than the regional median, although they have been mostly above three-month import coverage—the traditional rule of thumb for reserve adequacy. The recent declines have put Samoa's reserves at well below the regional median, which is more than one-month higher than Samoa's. While this comparison does not suggest Samoa's current level of reserves is inadequate, further declines could lead it to fall below CBS's target of 4 months of current year's imports.

International Reserves

(In months of next year's imports)



Source: IMF APDLISC database.
1/ In fiscal year July/June.

Staff analysis based on recent Fund methodologies for low-income countries suggests the optimal reserve holdings for Samoa are about 4½ months of imports. It should be noted that the estimate is sensitive to the assumed opportunity cost of holding reserves. The methodologies are essentially a cost-benefit analysis framework, whereby the optimal level of reserves is determined when the crisis prevention and mitigation benefits of reserves in smoothing absorption are balanced against the net financial cost of reserves, defined as foregone investment opportunities measured by the marginal product of capital. An important feature of this framework is that optimal

Variables	Country input
Government balance, % of GDP (5-year average)	-3.8
CPIA	4.0
Flexible exchange rate regime	No
External demand growth, percent	3.8
Terms of trade growth, percent	0.96
Change in FDI to GDP, percentage point of GDP	-5.2
Change in aid to GDP, percentage point of GDP	-0.01

reserve holdings depend on country characteristics and policy fundamentals such as the fiscal balance, CPIA, exchange rate regime, Fund program, terms of trade, external demand, FDI to GDP ratio and aid to GDP ratio. Samoa is a small, open and undiversified economy with a large fiscal deficit, fixed exchange rate regime, growing current account deficit. In calculating the optimal levels of reserves for Samoa, the opportunity cost of holding reserves was proxied by the average real bank lending rate of the past two years, estimated at about 3.8 percent.

It should be noted that the methodologies applied here are based on parameters derived from data on low-income countries. In fact, small countries such as Samoa were excluded from the data. Given this, results reported here should be treated with great caution. There is great uncertainty over the opportunity cost of holding reserves. The number used in this analysis is toward the lower end of available estimates for low-income countries (3-6 percent). With respect to the methodologies, the assumption of risk neutrality and the fact that Samoa is much smaller than a typical low-income country may lead to a downward bias for the estimates of optimal reserve holdings—small island economies are more vulnerable to exogenous shocks and may need higher levels of reserves, other things being equal.

INTERNATIONAL MONETARY FUND

SAMOA

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

June 1, 2012

Prepared By

Asia and Pacific Department
(In Consultation with Other Departments)

CONTENTS

ANNEX I. SAMOA—FUND RELATIONS

(As of April 30, 2012)

I. **Membership Status**: Joined: 12/28/1971; Article VIII

II. **General Resources Account**:	SDR Million	%Quota
Quota	11.60	100.0
Fund holdings of currency	10.92	94.12
Reserve tranche position	0.69	5.98

III. **SDR Department**:	SDR Million	%Allocation
Net cumulative allocation	11.09	100.00
Holdings	12.61	113.69

IV. **Outstanding Purchases and Loans**:	SDR Million	%Quota
ESF RAC Loan	5.80	50.00

V. **Latest Financial Arrangements**:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-by	07/09/1984	07/08/1985	3.38	3.38
Stand-by	06/27/1983	06/26/1984	3.38	3.38

VI. **Projected Payments to Fund** [1/]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2012	2013	2014	2015	2016
Principal				1.16	1.16
Charges/Interest	0.00	0.01	0.01	0.01	0.01
Total	0.00	0.01	0.01	1.17	1.17

[1/] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

VII. Exchange Rate Arrangement:

The exchange rate of the tala is pegged to a trade and payments weighted basket of currencies. The pegged rate can be adjusted within a ±2 percent band. The basket is a composite of the currencies of Samoa's most important trading partners and countries that are major sources of tourism revenue from abroad—New Zealand, Australia, the United States, and Euro countries.

VIII. Article IV Consultation:

The 2010 Article IV consultation discussions were held in Apia during March 2–6, 2010. The Executive Board discussed the staff report (IMF Country Report No. 10/214) and concluded the consultation on May 17, 2010.

IX. Technical Assistance:

The Pacific Financial Technical Assistance Centre (PFTAC) has provided assistance on budgetary management, tax administration, financial sector supervision, and balance of payments statistics. MCM has provided assistance on monetary policy operations, foreign reserves management, banking, and insurance supervision and other central banking issues. STA has provided help with national accounts and government finance statistics, and FAD with tax administration.

X. Safeguards Assessment

A first time safeguards assessment of the Central Bank of Samoa was completed on November 2010 with respect to the ESF-RAC arrangement approved on December 7, 2009. The assessment identified several vulnerabilities in the CBS safeguards framework that present risks for CBS governance, transparency, and risk management. Priority measures recommended by the assessment focus on establishing audit committee oversight, enhancing internal audit function, and appointing an international audit firm for an initial period of three years. Implementation of these recommendations is delayed. The CBS appointed a local external auditor for a two-year term starting in 2012.

XI. Resident Representative:

The Regional Resident Representative Office for Pacific Island Countries based in Suva Fiji was opened on September 13, 2010 and the office covers Fiji, Kiribati, Marshall Islands, Micronesia, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu. Mr. Yongzheng Yang is the resident representative.

ANNEX II. SAMOA—PFTAC COUNTRY STRATEGY 2012-2014

Background

Samoa has faced a difficult macroeconomic environment in recent times. Following the global economic crisis growth stagnated, remittances fell and fiscal revenues declined sharply. This was exacerbated by a devastating tsunami in mid-2009. Samoa responded with a substantial fiscal stimulus financed by domestic and external debt accumulation and also with monetary stimulus including central bank lending to nonbank financial institutions. Growth has however been slow to pick up and with fiscal deficits still relatively high, debt levels elevated and international reserves declining, the authorities will continue to face macroeconomic management challenges. Fortunately, with strong policy frameworks, good donor dialogue and coordination and a number of large institutional strengthening projects (ISP) already in place, Samoa is well placed to meet these challenges.

PFTAC has provided moderate TA to Samoa in recent years mainly on macro-fiscal and statistics. PFTAC TA was instrumental in setting up a medium-term budgeting system and the development of quarterly national accounts in Samoa, both of which are now supported by ISPs. Recent TA has been primarily in the macroeconomic area and is focused on developing a more reliable macroeconomic framework for the budget. Support has also been provided in Samoa's modernization of its income tax legislation.

Strategy 2012–2014

PFTAC's TA strategy is guided by the APD regional strategy note and is planned within the results framework for PFTAC's funding cycle.[1]

PFTAC TA aims to support the authorities sustain progress on fiscal consolidation and to improve the macroeconomic environment. PFTAC will continue to focus on building macroeconomic analysis capacity and delivering specific technical inputs in the context of larger ISPs. One instance of this is expected to be support to assessing revenue potential.

[1] The specific result in the framework that activities target is identified in italics in the section, for example cash management is referred to as (*1.6*), where 1.6 is the code in the result framework in the program document.

In the **Public Financial Management** area, inputs are expected to be relatively small given the large project-based support available to support the Ministry of Finance's PFM reform plan. PFTAC will be available to provide follow-up support to previous work to strengthen the medium-term budgeting system (*1.5*). In the medium-term, PFTAC would look to assist the authorities implement a follow-up PEFA assessment, probably in 2014 (*1.1*).

Assistance in the **macroeconomics** area will continue to be instrumental to the success of budget reforms. PFTAC will continue assisting Ministry of Finance improve the accuracy and sophistication of its revenue and GDP forecasting (5.1, 5.3) and in building capacity to produce its own debt sustainability analyses (5.4). This work will continue to aim to build stronger links with the Central Bank of Samoa (CBS)

In the **revenue** area, Samoa has made great strides in improving administration, which was reflected in an award at the 2011 PITAA annual meeting. Reflecting this, PFTAC hopes to draw on Samoan experiences to provide advice to other PFTAC members. Support to Samoa's revenue administration will continue to be mainly delivered under the ISP, which will include implementation of self-assessment (2.4) in line with the modernized income tax act, prepared with PFTAC support. PFTAC is ready to supplement the ISP, most likely through assisting the authorities undertake a strategic revenue review in late 2012 that will analyze recent revenue developments and identify policy (*2.1*) and administrative (*2.2-2.5*) actions that could help increase revenues. This may identify other areas for PFTAC support, including developing risk management and compliance strategies (*2.5*).

In **statistics**, Samoa is relatively well advanced against the overall results framework; based on PFTAC advice, it produces quarterly National Accounts on 2 independent measures (*4.1*) with production of a range of income indicators (*4.3*). Balance of payments statistics are now being developed according to BPM6 standards (*4.8*). Further development is expected to continue under the ISP, although PFTAC can assist with major methodological developments and rebases in the national accounts (4.1 and 4.2) and IMF HQ will offer support in Balance of Payments.

In **financial sector supervision**, PFTAC will be ready to assist CBS adapt the base set of prudential returns developed by AFSPC to the Samoan context in advance of the regional implementation of RBNZ's Financial Sector Information System (FSIS) (3.1, 3.2). CBS currently relies on APRA for training support in conducting on-site bank examinations, but PFTAC would be ready to supplement this if requested.

ANNEX III: SAMOA—RELATIONS WITH THE ASIAN DEVELOPMENT BANK GROUP

The Asian Development Bank operations in Samoa started in 1966: As at year-end 2011, 35 loans ($186.19 million), 7 ADF grants ($43.81 million), and 87 TA projects for $28.86 million have been provided to Samoa. Three loans ($45.49 million), 3 ADF grants ($27.06 million), and 5 TA projects ($2.19 million) are active.

The Country Partnership Strategy (CPS) 2008-12 for Samoa focuses on poverty reduction with three pillars for intervention: (i) removal of infrastructure constraints, (ii) improvement of access and delivery of public services, and (iii) promotion of private sector development. The CPS builds on a coordinated strategy with the other main development partners through focusing on sectors where ADB has a strong comparative advantage, particularly power, water, sanitation, drainage and private sector development.

ADB completed its country operations business plan (COBP) 2012-2014 in July 2011, adopting a harmonized approach to donor assistance with other development partners and maintaining the focus of the CPS and ADB's Pacific Approach targeting improvement of growth prospects and living standards, especially for disadvantaged members of the community. The COBP is closely aligned with the Strategy for the Development of Samoa (SDS).

Samoa has received support from the Pacific Infrastructure Advisory Center (PIAC) for infrastructure master planning and has also participated in the PIAC initiative for strengthening of power and water utilities. The country also benefits from the advisory services of the Pacific Financial Technical Assistance Center. Samoa has received ADB regional technical assistance for economic management for development results, energy efficiency, statistics and private sector development (including SOE reforms and secured transactions). ADB continues to include Samoa in new regional TA activities,

Most recently in April 2010 the Economic Recovery Support Program (totaling US$26.8 million) was approved. ADB approved a loan of $16 million for the first subprogram in 2010 with the second subprogram of $10.82 million approved in late 2011. Future assistance will focus on energy investments to improve access and bring down prices. The government has confirmed its interest in a renewable energy project as part of the COBP. ADB will also continue to support reforms to promote economic use of customary land, build sustainable capacity for sound economic and public sector management and implement state-owned enterprises reforms.

ADB loans to Samoa, 2005–11

	2005	2006	2007	2008	2009	2010	2011
Loan Approvals	8.1	0.0	26.6	2.8	0.0	14.0	5.4
Loan Disbursements	2.7	1.6	1.4	2.6	6.3	25.6	9.8
Cumulative loan amount available	128.1	122.8	150.8	152.6	146.3		
Cumulative disbursements	102.7	104.3	105.7	108.3	114.6		
Net loan amount undisbursed	21.6	17.4	18.5	18.0	11.7		17.5

ANNEX IV. SAMOA—RELATIONS WITH THE WORLD BANK GROUP

(As of March 2012)

Since Samoa became a Bank member in June 1974, 20 IDA credits totaling over $142.2 million have been committed. The Bank has also executed a range of trust fund financed activities. Bank finance for Samoa has focused on supporting the successful reform efforts since the mid-1990s. Investments have helped support critical road infrastructure, the finance sector, agricultural production, post-cyclone reconstruction, telecom sector reforms and health sector reforms.

Samoa: IDA Lending Operations (as of March 2012)

	Year of Approval	Original Amount	Undisbursed Balance
		(In millions of US dollars)	
Completed projects (IDA)			
First highway	1975	4.4	0
First highway	1975	4.4	0
Agricultural development	1979	8.0	0
Second agricultural development	1980	2.0	0
Development Bank	1985	2.0	0
Multi-sector Project	1986	2.5	0
Afulilo hydroelectric dam (AsDB)	1987	3.0	0
Telecommunications (AsDB)	1989	4.6	0
Emergency road rehabilitation	1990	14.0	0
Afulilo hydroelectric dam supplement (AsDB)	1993	1.0	0
Emergency road rehabilitation supplement	1993	5.1	0
Infrastructure asset management (Phase I)	1999	14.4	0
Health sector management	2000	5.0	0
Cyclone emergency reconstruction	2004	4.5	0
Telecommunications and Postal Reform	2002	6.6	0
Development Program Credit (Budget Support)	2010	20.0	0
Current projects (IDA)			
Second Infrastructure Asset Mgmt (& '07 Supplement)	2003	21.1	5.7
Health Sector Management	2008	3.0	0.8
Health Sector Management (additional financing)	2009	3.0	0
Post Tsunami Reconstruction Project	2010	10.0	8.7
Agriculture Competitiveness Enhancement Project	2012	8.0	0
Total		142.2	15.2

Samoa has an IDA-15 (FY09–FY11) allocation of $40 million. Samoa's IDA-15 allocation was more than doubled to respond to the devastating tsunami that occurred on September 29, 2009.

The Bank's current activities in Samoa are in the following areas:

1) Transport Sector

Infrastructure Asset Management Phase 2: The objective of this second-phase program (approved December 2003, US$12.8 million plus additional finance of US$8 million and significant trust fund support), to be carried out over a period of eight years, is to enhance the economic, environmental and social sustainability of transport and coastal infrastructure assets, and to manage these assets, natural resources, and disaster risks through an effective partnership with private sector stakeholders. The success of efforts to build private sector contracting capacity––a central element of the program—was evident in the rapid and effective response by the Samoan Government and private sector to tsunami recovery and reconstruction efforts.

Post Tsunami Road Reconstruction Project: The development objective of this project is to assist the Government of Samoa in its efforts to support the relocation and rehabilitation of communities living on the island of Upolu affected by the tsunami of September 2009, through the provision of improved infrastructure access to relocation sites, enhanced transport infrastructure and assistance to local communities to address future natural disasters. The project is being implemented in conjunction with the current successful SIAM2 operation and is co-financed with a US$1.8 million grant from the Pacific Region Infrastructure Facility.

2) Health Sector

Health Sector Management Program: Through the Health Sector Management project (approved June 2008, IDA US$3 million), the Bank is supporting the government's reform program aimed at promoting preventative healthcare, and ensuring equitable access to a modern, effective, efficient health service, delivered in close collaboration with the private sector. Implementation is done using a sector-wide approach with co-financing from AUSAID and NZAP, and in close coordination with other health sector development partners such as UNFPA and WHO. Samoa is broadly on track to meet health sector MDGs.

Additional Financing - Health Sector Management Program: Additional financing of US$3 million was provided to assist Samoa in addressing pressures on the health system emerging as a result of the tsunami.

3) Agriculture Sector

Agriculture Competitiveness Enhancement Project: The development objective of the project is to support fruit and vegetable growers and livestock producers to improve their productivity and take greater advantage of market opportunities. The project will cover 3 components – (i) livestock production and marketing, (ii) fruit and vegetable production and marketing, and (iii) institutional strengthening of agricultural institutions. Co-financing of US$5million grant is provided from the Food Price Crisis Response Core Multi-donor Trust Fund.

IFC has been active in Samoa, particularly in the telecoms sector. IFC has invested US$18.5 million in Digicel, encouraging this new private operator to enter the liberalized Samoan telecoms market. This has been a crucial element in the successes achieved in improving connectivity in Samoa. IFC investments have encouraged over US$80 million in total private investment in the telecoms sector, making this the largest single private investment in Samoa. IFC has also been providing assistance to the tourism sector and recently to the Ministry of Justice & Courts Administration for establishment of its courts mediation unit.

In support of a significantly scaled up program, the Bank in November 2009 opened a joint liaison office in Samoa, in conjunction with the Asian Development Bank.

ANNEX V. SAMOA—STATISTICAL ISSUES

Data provision is broadly adequate for surveillance. Core economic and monetary data are updated regularly and published on official websites. However, balance of payments data are limited and subject to frequent revisions while expenditure-based national account data are under development.
Samoa participated in the Pacific Regional General Data Dissemination System (GDDS) Project in November 2003. The metadata is undergoing review prior to web-posting consultations with country authorities. On-going technical assistance has been provided by STA and PFTAC to improve national account statistics and financial sector indicators. The standardized report forms (SRFs) for reporting monetary data to the IMF and an integrated monetary database became effective in January 2009.

Table of Common Indicators Required for Surveillance
(As of April 20, 2012)

	Date of Latest Observation	Date Received	Frequency of Data[4]	Frequency of Reporting[4]	Frequency of Publication[4]
Exchange Rates	02/12	04/3/12	D	D	D
Gross International Reserves	03/12	04/20/12	M	M	M
Reserve/Base Money	02/12	03/30/12	M	M	M
Broad Money	02/12	03/30/12	M	M	M
Central Bank Balance Sheet	02/12	03/30/12	M	M	M
Consolidated Balance Sheet of the Banking System[1]	02/12	03/30/12	M	M	NA
Interest Rates[2]	02/12	03/30/12	M	M	M
Consumer Price Index	02/12	03/30/12	M	M	M
Revenue, Expenditure, Balance and Composition of financing[3]– Central Government	Q2 2011	04/12	Q	Q	Q
Stocks of Central Government Debt	Q3 2011	04/12	Q	Q	NA
External Current Account Balance	Q4 2011	04/12	Q	Q	Q
Exports and Imports of Goods	Q4 2011	04/12	M	M	M
GDP	Q4 2011	04/12	Q	Q	Q
Gross External Debt	Q3 2011	04/12	Q	Q	Q

[1] Data obtained directly from the Central Bank of Samoa.
[2] Officially-determined rates (yields on central bank securities) and commercial banks' deposit and lending rates.
[3] Domestic and external financing.
[4] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

INTERNATIONAL MONETARY FUND

SAMOA

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

June 1, 2012

Approved By
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Prepared by
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This joint IMF-WB debt sustainability analysis (DSA) shows that Samoa has shifted to moderate from low risk of debt distress.[1] *Compared to the previous DSA (see 2010 Article IV Staff Report), this analysis assumes a slightly lower medium- and long-term growth rate of GDP in the baseline given the less favorable external environment and the dissipation of the benefits of earlier reforms. The analysis finds that there is a large and protracted breach of the present value of debt to GDP threshold in an exchange rate shock scenario. Given the rising debt burden, forceful policy actions, especially on the fiscal front, would be needed to ensure medium- and long-term debt sustainability.*

[1] This DSA was prepared by IMF and IDA staffs in accordance with the standard methodology for low-income countries. It is based on the general framework approved by the Executive Boards of the IMF and the World Bank, including the recent revisions to the framework endorsed by the two Boards (SM/12/10)

BACKGROUND

1. **Samoa is currently faced with the challenge of slow growth and high volatility arising from exogenous shocks.** The economy is particularly exposed to external factors impacting tourism, remittances and aid which Samoa is largely reliant on. Goods exports are small and comprise a limited number of agricultural products.

2. **The Samoan economy has not fully recovered from the impact of the global financial crisis and the 2009 tsunami.** Tourism is still declining, albeit at a slower pace. Reconstruction activity, which has been supporting economic recovery, is in the process of winding down. Growth is projected to be around 1½-2 percent in the short term and rise to 2½ percent over the medium term which is close to the 10-year historical average. This outlook is subject to considerable uncertainty given the current global, regional and domestic environment.

3. **The fiscal expansion following the global slowdown and the tsunami was supported by both multilateral (ADB and IDA) and bilateral partners (Australia, New Zealand, China, and Japan).** Samoa has benefited from grants and concessional loans, which have made its debt stock much smaller in present value terms and debt repayment much less costly.

4. **At the end of 2010/2011 fiscal year, the face value of public external debt was estimated at 737.7 million tala (48 percent of GDP) and domestic debt at 48.9 million tala (3.9 percent of GDP).** Multilateral creditors account for 71 percent of Samoa's external debt (including 32.3 percent owed to the World Bank, 35.3 percent to ADB, and 3.4 percent to OPEC, IFAD, EEC and EIB). Bilateral creditors (JICA, China, and France) account for approximately 29 percent of the external debt.

5. **Samoa has managed its debt relatively well with most of external government debt being contracted on concessional terms**. Non-concessional loans from OPEC are small and attract interest rates ranging from 2.75 percent to 4.5 percent while those on other loans range from 0.45 percent to 2.5 percent.

6. **The central government's net domestic debt is small**. Treasury bonds outstanding are worth only 0.4 million tala with interest rates ranging from 5 percent to 7 percent. The government has assumed the responsibility for repaying a number of public enterprise (PE) loans that are in default with an outstanding balance of 48.5 million tala at end of FY 2011. PE liabilities, although backed by their assets, represent a fiscal risk to the government. Total current liabilities are reported

to be at 100.9 million tala at the end of 2010 fiscal year and non-current liabilities at 267.9 million tala. Not all PE balance sheets were available as of end of 2011 fiscal year.

METHODOLOGY AND ASSUMPTIONS

7. **Debt sustainability is assessed in relation to policy-dependent debt burden thresholds**. Samoa is classified as a "strong performer" according to the three-year average of IDA's Country Policy and Institutional Assessment (CPIA) index under the joint IMF/IDA debt sustainability framework.[2] Samoa's debt is therefore assessed against higher thresholds compared to countries that have a weaker governance and policy environment.[3]

8. **This DSA is based on updated data provided by the authorities supplemented with staffs' estimates.** It covers borrowings by the central government and public enterprises (including defaulted public enterprise loans currently being repaid by government) based on available data and forecasts. The DSA uses non-reconciled debt data and a single discount rate of 4 percent.

9. **Key assumptions underlying the baseline DSA are consistent with the macroeconomic framework developed during the 2012 Article IV consultation and afterwards.** These assumptions are as follows except for the modifications specified in alternative scenarios:

- Annual real GDP growth is projected at 1.5 percent for fiscal year 2011/12, improving gradually to 2.5 percent over the long term, which is higher than the average GDP growth of 0.9 percent for 2005/06-2010/11, a period when the Samoan economy was subject to a series of adverse shocks.

- Average inflation is assumed to be about 6.0 percent for 2011/12, falling to 2.0 percent in 2012-2013. Over the medium term, inflation is projected to be about 4.0 percent (about the historical average) and falling to 3.0 percent over the long term, in line with the target set by the Central Bank of Samoa (CBS).

[2] Three year average CPIA rating for Samoa is 4.06.

[3] According to the 2012 review of the Debt Sustainability Framework for Low Income Countries, the thresholds for "strong performers" are: 50 percent for PV of debt to GDP; 200 percent for PV of debt to exports; 300 percent for PV of debt to revenues; 25 percent debt service to exports; and 22 percent debt service to revenues.

- A constant real effective exchange rate is assumed for the medium term, and, for simplicity, a constant real exchange rate against the U.S. dollar is assumed over the long run.

- Annual goods and services export growth is assumed at about 4 percent in nominal US dollar terms. The external non-interest current account deficit is projected at about 10½ percent of GDP in 2011/12 falling to about 8 percent by 2016/17. An annual average current account balance of slightly lower than 8 percent of GDP is assumed over the 2018-32 period. The current account deficit is expected to be largely financed by grants and concessional loans from development partners.

- A fiscal consolidation is assumed to take place over the medium term, gradually reducing the fiscal deficit to 2½ percent of GDP. Over the longer term, the deficit will be further reduced and maintained at 1½ percent of GDP. Revenues are assumed to remain constant at about 32 percent of GDP, and development expenditure is reduced to about 11 percent of GDP, financed by grants, concessional loans and domestic resources. This is 7 percentage points below the level during the post-tsunami reconstruction period which included one-off donor support. Current expenditure in the long run is assumed to be about 22 percent of GDP, following a gradual decline from 25 percent of GDP over the medium term, consistent with phasing out of reconstruction projects and the authorities intention to streamline the public administration sector. Samoa's interest expenditure is not large as most borrowing is on concessional terms.

- New external borrowing will be required (largely available on concessional terms) to finance the fiscal deficit. Central government domestic debt is about 3 percent of GDP and PE debt about 27 percent of GDP (excluding defaulted loans that the government has taken over). Assumptions about new borrowing include budget support loans from multilateral development partners. PE borrowing is assumed to be on commercial terms. Continued eligibility for concessional borrowing from IDA is assumed during the forecast period.

- PE balance sheet data for 2011 fiscal year was incomplete. For the purposes of public sector DSA it is assumed that there is no change in the debt levels from 2010 fiscal year for PEs with missing balance sheet information for 2011 fiscal year. PE debt is assumed to be constant as a percentage of GDP for the projection period.

EXTERNAL DEBT SUSTAINABILITY

10. **Under the baseline scenario, all initial debt ratios are below the policy-dependent thresholds for a low income country classified as a strong performer on policy ratings.** Nevertheless, these ratios are projected to exceed the target of 40 percent of GDP in PV terms set by the authorities (Figure 1; Tables 1a, 1b and 1c), reflecting the continued need to borrow and the rapid accumulation of external debt as a result of fiscal expansion in the wake of the global financial crisis and the tsunami.

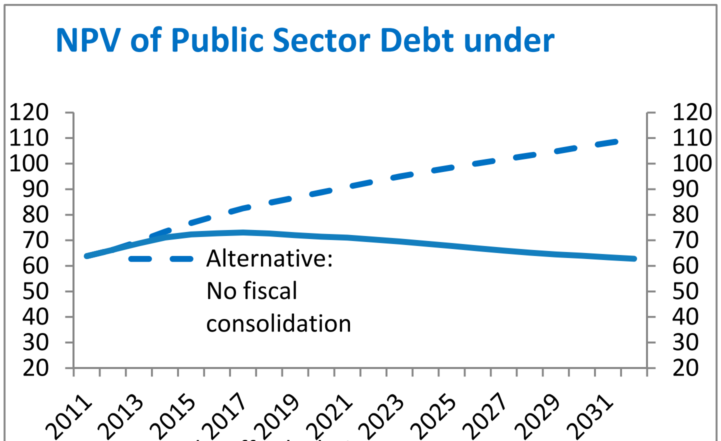
11. **Stress tests indicate that Samoa faces a moderate risk of debt distress, a step up from its low risk status in the last assessment.** The increase in risk of debt distress reflects weaker output growth and slower fiscal consolidation in comparison to the last DSA. Samoa's external debt situation is generally resilient but shocks would lead to a sharp initial worsening in debt indicators. The most extreme stress tests show that an exchange rate shock of 30 percent would push the PV of public external debt as a share of GDP from 39 percent in 2012 to significantly above 50 percent for the entire forecast period, the PV of debt-to revenue ratio from 157 percent to 246 percent, the PV of debt to exports from 132 percent to 199 percent, and the debt service to revenue ratio from 5 percent to 18 percent over a number of years. Over time, however, all but the PV of debt to exports measure improve as the one-off effects of the shocks dissipate.[4]

12. **An "historical" scenario, which replicates the past performance of key economic variables, yields debt ratios that are below the current baseline projections (Figure 1).** Samoa has historically had sound macroeconomic policies supported by an array of structural reforms that had resulted in a period of sustained growth. However, there was a step down in output growth in years just preceding the global crisis. The global crisis hit Samoa hard and the country suffered another blow when a tsunami hit its tourism-oriented region.

[4] Given the large and protracted breach of the PV of debt to GDP threshold, the consideration of Samoa's large remittances in the assessment would not be able to help reduce the moderate risk rating.

PUBLIC SECTOR DSA

13. **The public sector debt analysis supports the conclusions drawn from the external debt analysis (Figure 2; Tables 2a and 2b).**[5] The nominal value of public sector debt stock is estimated at 76 percent of GDP in FY2011 (62.8 percent of GDP in PV terms) and is expected to rise to 80 percent of GDP (66 percent of GDP in PV terms) in the current fiscal year. Scenario analysis shows that if Samoa failed to undertake fiscal consolidation, public sector debt would keep growing over the entire forecast period, with the PV of public debt exceeding 100 percent of GDP toward the end of the forecast period.



Source: Fund staff calculations

CONCLUSION AND STAFF ASSESSMENT

14. **Despite its reliance on concessional external borrowing and continued support from development partners, Samoa is now faced with a moderate risk of debt distress.** Because of the slower-than-anticipated recovery and less favorable growth prospects, the underlying risk of debt distress has moved upward. This DSA shows that while Samoa's debt path is generally resilient to shocks, it is very vulnerable to exchange rate shocks. Scenario analysis indicates that Samoa would be even more vulnerable to such shocks should the country fail to reduce its fiscal deficit to a more sustainable level over the medium term.

15. **Samoa's challenges for maintaining a sustainable level of public debt have increased in recent years.** Achieving the growth and export projections in the baseline scenario would require policies to maintain macroeconomic stability, continued investment in and maintenance of infrastructure, and structural reforms to improve the investment climate and increase economic efficiency, particularly that of public enterprises. Samoa would need to develop a credible deficit-

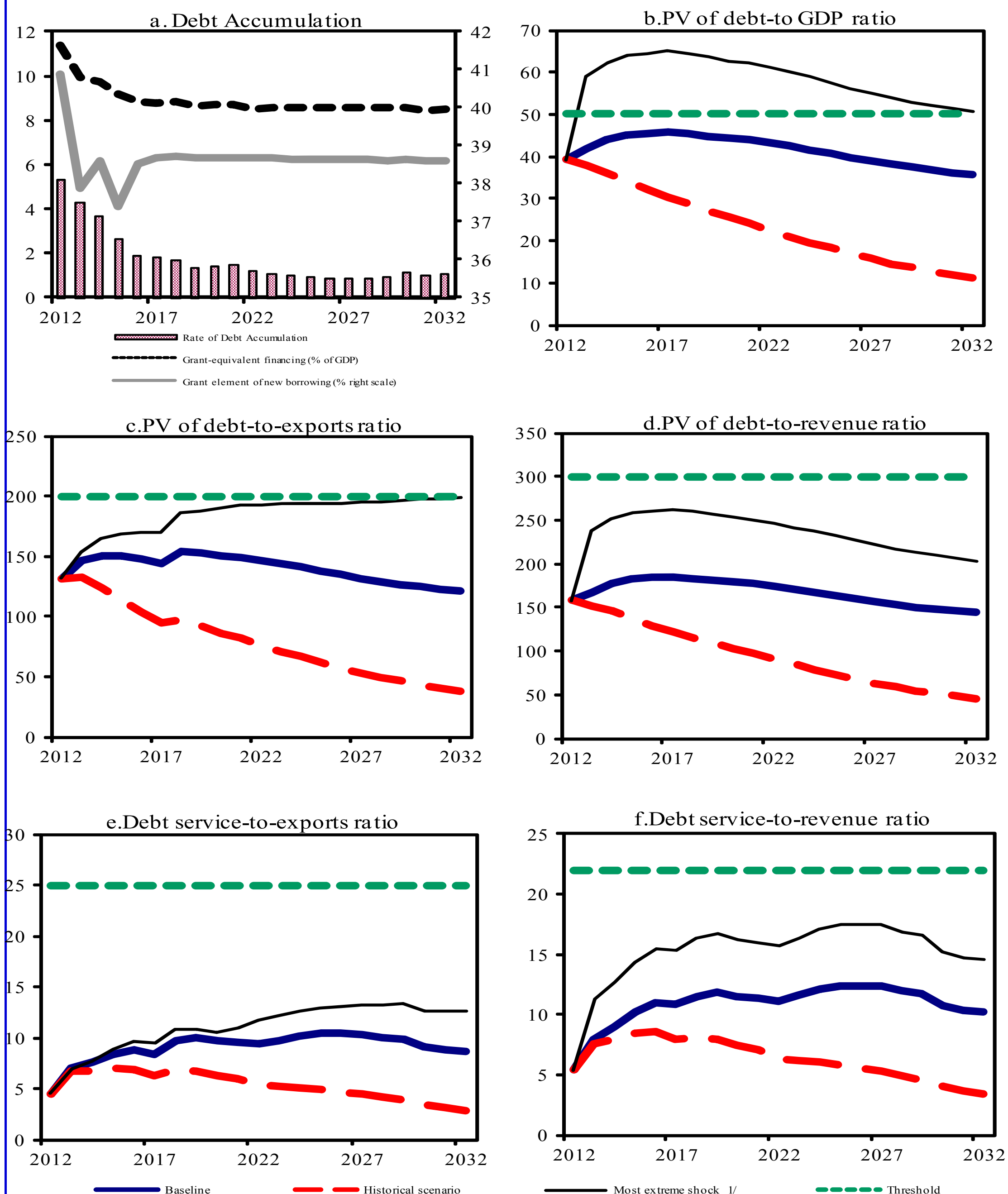
[5] Public sector debt includes all external debt of the central government, including on-lent amounts, domestic debt of the central government, defaulted loans of PEs, and PE current and non-current liabilities (excluding government on-lending and inter-PE loans).

reduction plan over the medium term and further improve debt management to support fiscal consolidation. Sustained efforts would be needed to rebuild policy buffers against future shocks.

AUTHORITIES' VIEWS

16. **The authorities recognize the risks posed by the high and rising debt burdens and are committed to bringing them down to more sustainable levels.** They agreed that it is critical to formulate and implement a credible fiscal consolidation plan and to strengthen debt management and undertake structural reforms to boost growth.

Figure 1. Samoa: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2012-2032 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2022. In figure b. it corresponds to a One-time depreciation shock; in c. to a Terms shock; in d. to a One-time depreciation shock; in e. to a Terms shock and in figure f. to a One-time depreciation shock

Table 1a.: External Debt Sustainability Framework, Baseline Scenario, 2009-2032 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections									
	2009	2010	2011			2012	2013	2014	2015	2016	2017	2012-2017 Average	2022	2032	2018-2032 Average
External debt (nominal) 1/	**45.3**	**53.6**	**49.3**			**53.2**	**57.1**	**60.8**	**62.6**	**63.4**	**64.1**		**61.0**	**51.8**	
o/w public and publicly guaranteed (PPG)	45.3	53.6	49.3			53.2	57.1	60.8	62.6	63.4	64.1		61.0	51.8	
Change in external debt	45.3	8.3	-4.2			3.9	3.9	3.6	1.9	0.8	0.6		-1.0	-0.7	
Identified net debt-creating flows	...	3.5	6.1			10.6	9.9	9.0	8.2	7.6	7.2		6.6	6.8	
Non-interest current account deficit	**2.6**	**6.5**	**7.4**	**8.3**	**3.7**	**10.5**	**10.6**	**9.9**	**9.2**	**8.6**	**8.1**		**7.7**	**7.9**	7.8
Deficit in balance of goods and services	24.2	26.6	27.2			28.8	29.3	28.6	27.9	27.3	26.8		24.8	24.8	
Exports	34.0	32.0	31.7			29.7	28.4	29.3	30.1	31.0	31.9		29.5	29.5	
Imports	58.1	58.5	58.8			58.5	57.6	57.9	58.1	58.3	58.7		54.3	54.3	
Net current transfers (negative = inflow)	-24.4	-22.5	-23.3	-22.5	1.5	-21.8	-21.9	-21.9	-21.8	-21.8	-21.7		-20.0	-20.0	-20.0
o/w official	-0.3	0.0	-0.4			-0.3	-0.3	-0.3	-0.3	-0.2	-0.2		-0.2	-0.1	
Other current account flows (negative = net inflow)	2.8	2.4	3.5			3.5	3.2	3.2	3.1	3.0	3.0		2.9	3.1	
Net FDI (negative = inflow)	**-1.6**	**-0.2**	**-1.5**	**-1.7**	**1.9**	**0.3**	**-0.4**	**-0.4**	**-0.4**	**-0.4**	**-0.4**		**-0.4**	**-0.4**	-0.4
Endogenous debt dynamics 2/	**...**	**-2.8**	**0.2**			**-0.2**	**-0.3**	**-0.5**	**-0.6**	**-0.6**	**-0.6**		**-0.7**	**-0.7**	
Contribution from nominal interest rate	...	0.8	1.3			0.4	0.7	0.7	0.9	1.0	1.0		0.7	0.6	
Contribution from real GDP growth	0.0	-0.2	-1.1			-0.6	-1.0	-1.3	-1.5	-1.6	-1.5		-1.5	-1.2	
Contribution from price and exchange rate changes	0.0	-3.5	0.0			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**...**	**4.8**	**-10.3**			**-6.7**	**-6.0**	**-5.4**	**-6.3**	**-6.8**	**-6.5**		**-7.6**	**-7.5**	
o/w exceptional financing	...	-1.4	0.0			0.0	0.0	0.0	0.1	0.2	0.2		0.0	0.0	
PV of external debt 4/	...	...	36.7			39.2	41.7	44.0	45.2	45.6	45.9		43.2	35.7	
In percent of exports	...	...	115.9			131.7	146.9	150.5	150.2	147.2	144.0		146.5	121.1	
PV of PPG external debt	**...**	**...**	**36.7**			**39.2**	**41.7**	**44.0**	**45.2**	**45.6**	**45.9**		**43.2**	**35.7**	
In percent of exports	**...**	**...**	**115.9**			**131.7**	**146.9**	**150.5**	**150.2**	**147.2**	**144.0**		**146.5**	**121.1**	
In percent of government revenues	**...**	**...**	**131.2**			**157.8**	**167.9**	**177.4**	**182.2**	**183.8**	**185.0**		**174.1**	**143.9**	
Debt service-to-exports ratio (in percent)	**1.7**	**2.4**	**3.9**			**4.5**	**7.0**	**7.6**	**8.4**	**8.8**	**8.4**		**9.4**	**8.7**	
PPG debt service-to-exports ratio (in percent)	**1.7**	**2.4**	**3.8**			**4.5**	**7.0**	**7.6**	**8.4**	**8.8**	**8.4**		**9.4**	**8.7**	
PPG debt service-to-revenue ratio (in percent)	**2.1**	**3.0**	**4.3**			**5.4**	**8.0**	**9.0**	**10.2**	**11.0**	**10.8**		**11.1**	**10.3**	
Total gross financing need (Millions of U.S. dollars)	8.7	43.9	45.2			86.9	90.6	90.3	89.6	89.0	87.8		105.5	162.2	
Non-interest current account deficit that stabilizes debt ratio	-42.7	-1.8	11.6			6.6	6.7	6.3	7.3	7.7	7.5		8.8	8.6	
Key macroeconomic assumptions															
Real GDP growth (in percent)	-5.1	0.4	2.0	2.7	3.4	1.5	1.9	2.3	2.5	2.6	2.5	2.2	2.5	2.5	2.5
GDP deflator in US dollar terms (change in percent)	20.0	8.3	0.1	6.2	9.1	10.9	2.3	0.8	0.8	0.7	0.7	2.7	1.9	1.9	1.9
Effective interest rate (percent) 5/	...	2.0	2.5	2.2	0.3	0.9	1.3	1.3	1.5	1.6	1.6	1.4	1.2	1.1	1.2
Growth of exports of G&S (US dollar terms, in percent)	19.0	2.4	1.1	7.0	9.9	5.7	-0.6	6.3	6.3	6.3	6.3	5.0	4.4	4.4	3.9
Growth of imports of G&S (US dollar terms, in percent)	22.9	9.5	2.6	9.3	13.3	12.0	2.6	3.5	3.5	3.8	3.9	4.9	4.4	4.4	3.9
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	40.9	37.9	38.6	37.4	38.5	38.7	38.7	38.7	38.6	38.7
Government revenues (excluding grants, in percent of GDP)	26.7	25.6	28.0			24.8	24.8	24.8	24.8	24.8	24.8		24.8	24.8	24.8
Aid flows (in Millions of US dollars) 7/	44.4	65.4	60.1			93.8	82.1	84.6	81.5	81.8	80.9		96.0	146.6	
o/w Grants	44.4	65.4	60.1			58.1	53.0	54.6	56.4	58.2	60.1		74.6	114.8	
o/w Concessional loans	0.0	0.0	0.0			35.7	29.2	30.0	25.1	23.6	20.8		21.4	31.8	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			11.4	9.9	9.8	9.2	8.9	8.8		8.5	8.5	8.6
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			70.9	68.4	69.9	72.9	76.1	76.7		79.3	79.8	78.6
Memorandum items:															
Nominal GDP (Millions of US dollars)	571.7	621.5	634.4			713.8	743.9	766.8	791.8	817.8	844.5		1047.7	1612.5	
Nominal dollar GDP growth	13.8	8.7	2.1			12.5	4.2	3.1	3.3	3.3	3.3	4.9	4.4	4.4	4.4
PV of PPG external debt (in Millions of US dollars)			245.6			279.6	310.1	337.7	358.2	373.1	387.9		452.8	576.0	
(PVt-PVt-1)/GDPt-1 (in percent)						5.3	4.3	3.7	2.7	1.9	1.8	3.3	1.2	1.0	1.1
Gross workers' remittances (Millions of US dollars)	137.4	139.8	145.2			153.7	161.2	166.0	170.9	175.9	181.1		207.9	320.0	
PV of PPG external debt (in percent of GDP + remittances)	...	...	29.9			32.2	34.3	36.2	37.2	37.5	37.8		36.1	29.8	
PV of PPG external debt (in percent of exports + remittances)	...	...	67.3			76.4	83.3	86.5	87.5	86.9	86.1		87.6	72.4	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	2.2			2.6	4.0	4.4	4.9	5.2	5.0		5.6	5.2	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that PV of private sector debt is equivalent to its face value.
5/ Current-year interest payments divided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
7/ Defined as grants, concessional loans, and debt relief.
8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 1b.Samoa: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2012-2032
(In percent)

	Projections							
	2012	2013	2014	2015	2016	2017	**2022**	2032
PV of debt-to GDP ratio								
Baseline	39	42	44	45	46	46	**43**	36
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	39	38	36	34	32	30	**23**	11
A2. New public sector loans on less favorable terms in 2012-2032 2	39	44	48	51	53	54	**57**	59
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	39	42	44	45	46	46	**43**	36
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	39	42	46	48	48	48	**45**	37
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	39	44	48	49	50	50	**47**	39
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	39	43	46	47	47	48	**45**	37
B5. Combination of B1-B4 using one-half standard deviation shocks	39	42	45	46	47	47	**44**	36
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	39	59	62	64	65	65	**61**	51
PV of debt-to-exports ratio								
Baseline	132	147	151	150	147	144	**147**	121
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	132	133	124	114	103	95	**76**	38
A2. New public sector loans on less favorable terms in 2012-2032 2	132	154	164	169	170	170	**193**	199
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	132	147	151	150	147	144	**147**	121
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	132	152	178	177	173	170	**173**	140
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	132	147	151	150	147	144	**147**	121
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	132	150	157	156	153	150	**152**	124
B5. Combination of B1-B4 using one-half standard deviation shocks	132	142	152	152	149	146	**148**	123
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	132	147	151	150	147	144	**147**	121
PV of debt-to-revenue ratio								
Baseline	158	168	177	182	184	185	**174**	144
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	158	152	146	138	129	121	**91**	45
A2. New public sector loans on less favorable terms in 2012-2032 2	158	176	194	205	212	218	**229**	236
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	158	168	177	182	184	185	**174**	144
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	158	170	187	192	193	195	**183**	148
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	158	177	194	199	201	202	**190**	157
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	158	172	185	190	191	192	**181**	147
B5. Combination of B1-B4 using one-half standard deviation shocks	158	169	181	186	187	189	**178**	147
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	158	238	251	258	260	262	**246**	204

Table 1b (continued).Samoa: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2012-2032
(In percent)

Debt service-to-exports ratio

Baseline	4	7	8	8	9	8	**9**	9
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	4	7	6	6	6	5	**4**	1
A2. New public sector loans on less favorable terms in 2012-2032 2	4	7	8	9	10	10	**12**	13
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	4	7	8	8	9	8	**9**	9
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	4	7	9	10	10	10	**11**	10
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	4	7	8	8	9	8	**9**	9
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	4	7	8	9	10	9	**12**	11
B5. Combination of B1-B4 using one-half standard deviation shocks	4	7	8	9	10	9	**11**	10
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	4	7	8	8	9	8	**9**	9

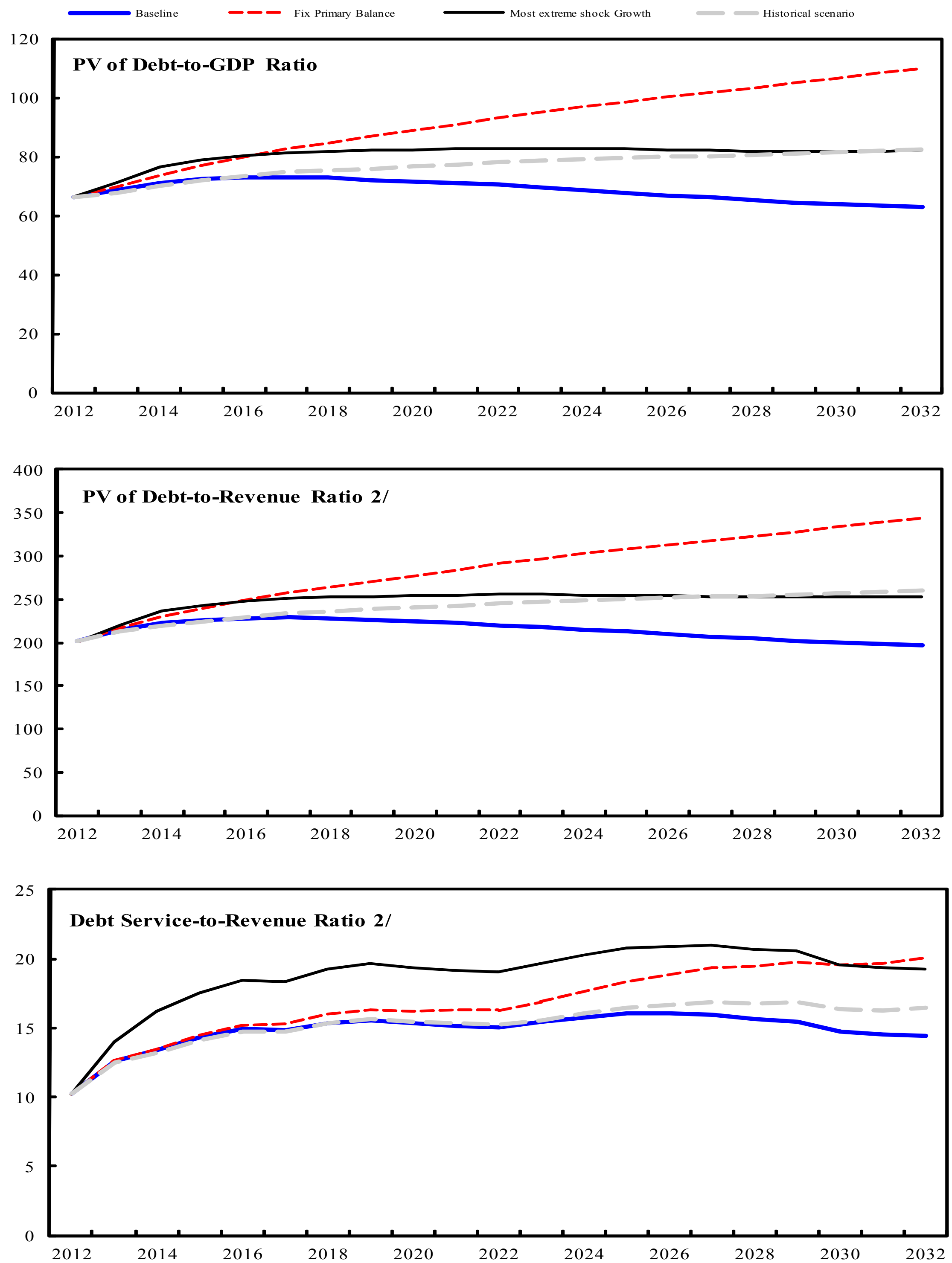
Debt service-to-revenue ratio

Baseline	5	8	9	10	11	11	**11**	10
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	5	7	8	8	8	7	**5**	1
A2. New public sector loans on less favorable terms in 2012-2032 2	5	8	9	11	12	12	**14**	15
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	5	8	9	10	11	11	**11**	10
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	5	8	9	10	11	11	**11**	11
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	5	8	9	11	11	11	**12**	11
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	5	8	10	12	12	12	**14**	14
B5. Combination of B1-B4 using one-half standard deviation shocks	5	8	9	11	11	11	**12**	12
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	5	11	13	14	16	15	**16**	15
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	36	36	36	36	36	36	**36**	36

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Figure 2.Samoa: Indicators of Public Debt Under Alternative Scenarios, 2012-2032 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2022.
2/ Revenues are defined inclusive of grants.

Table 2a.Samoa: Public Sector Debt Sustainability Framework, Baseline Scenario, 2009-2032
(In percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Estimate	Projections								
	2009	2010	2011			2012	2013	2014	2015	2016	2017	2012-17 Average	2022	2032	2018-32 Average
Public sector debt 1/	75.9	82.9	76.4			80.3	84.2	87.9	89.7	90.5	91.2		88.1	78.9	
o/w foreign-currency denominated	45.3	53.6	49.3			53.2	57.1	60.8	62.6	63.4	64.1		61.0	51.8	
Change in public sector debt	75.9	6.9	-6.4			3.9	3.9	3.6	1.9	0.8	0.6		-1.0	-0.7	
Identified debt-creating flows	...	2.1	-1.6			0.9	1.9	0.7	-0.6	-1.1	-1.2		-2.5	-2.1	
Primary deficit	1.3	4.7	3.0	1.4	1.7	3.6	2.3	1.2	0.1	-0.5	-0.5	1.0	-1.2	-1.1	-1.0
Revenue and grants	34.5	36.2	37.5			33.0	31.9	31.9	31.9	31.9	31.9		31.9	31.9	
of which: grants	7.8	10.5	9.5			8.1	7.1	7.1	7.1	7.1	7.1		7.1	7.1	
Primary (noninterest) expenditure	35.8	40.8	40.5			36.5	34.3	33.2	32.0	31.5	31.4		30.7	30.9	
Automatic debt dynamics	...	-2.5	-4.6			-2.7	-0.5	-0.6	-0.7	-0.6	-0.7		-1.3	-1.0	
Contribution from interest rate/growth differential	...	0.8	-0.1			-1.0	-0.3	-1.2	-1.3	-1.4	-1.4		-1.3	-1.0	
of which: contribution from average real interest rate	...	1.1	1.5			0.1	1.2	0.7	0.8	0.9	0.8		0.9	0.9	
of which: contribution from real GDP growth	0.0	-0.3	-1.6			-1.1	-1.5	-1.9	-2.1	-2.2	-2.2		-2.2	-1.9	
Contribution from real exchange rate depreciation	...	-3.4	-4.5			-1.6	-0.2	0.6	0.6	0.7	0.7		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	...	4.8	-4.8			3.0	2.1	3.0	2.5	1.9	1.8		1.4	1.4	
Other Sustainability Indicators															
PV of public sector debt	...	...	63.8			66.3	68.8	71.1	72.3	72.7	73.0		70.3	62.8	
o/w foreign-currency denominated	...	...	36.7			39.2	41.7	44.0	45.2	45.6	45.9		43.2	35.7	
o/w external	...	...	36.7			39.2	41.7	44.0	45.2	45.6	45.9		43.2	35.7	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	4.2	13.9	13.1			11.6	11.2	10.3	9.4	9.1	9.0		8.4	8.4	
PV of public sector debt-to-revenue and grants ratio (in percent)	…	…	170.4			201.0	215.4	222.7	226.5	227.7	228.6		220.1	196.7	
PV of public sector debt-to-revenue ratio (in percent)	…	…	228.0			267.0	277.1	286.6	291.4	293.0	294.2		283.3	253.1	
o/w external 3/	…	…	131.2			157.8	167.9	177.4	182.2	183.8	185.0		174.1	143.9	
Debt service-to-revenue and grants ratio (in percent) 4/	8.5	7.8	9.1			10.3	12.6	13.4	14.3	14.9	14.8		15.0	14.4	
Debt service-to-revenue ratio (in percent) 4/	11.0	11.0	12.2			13.6	16.2	17.2	18.4	19.2	19.1		19.4	18.5	
Primary deficit that stabilizes the debt-to-GDP ratio	-74.6	-2.3	9.4			-0.3	-1.6	-2.4	-1.8	-1.3	-1.1		-0.2	-0.4	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	-5.1	0.4	2.0	2.7	3.4	1.5	1.9	2.3	2.5	2.6	2.5	2.2	2.5	2.5	2.5
Average nominal interest rate on forex debt (in percent)	...	2.0	2.5	2.2	0.3	0.9	1.3	1.3	1.5	1.6	1.6	1.4	1.2	1.1	1.2
Average real interest rate on domestic debt (in percent)	...	5.2	5.5	5.3	0.2	1.5	5.8	3.9	3.9	3.9	3.9	3.8	4.9	4.9	4.9
Real exchange rate depreciation (in percent, + indicates depreciation)	3.5	-7.5	-8.6	-4.3	4.8	-3.4	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	3.0	1.5	2.2	4.2	2.1	6.6	1.9	4.0	4.0	4.0	4.0	4.1	2.9	2.9	2.9
Growth of real primary spending (deflated by GDP deflator, in percent)	0.0	0.1	0.0	0.1	0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grant element of new external borrowing (in percent)	...	...	...	…	…	40.9	37.9	38.6	37.4	38.5	38.7	38.7	38.7	38.6	...

Sources: Country authorities; and staff estimates and projections.
1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues excluding grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2b.Samoa: Sensitivity Analysis for Key Indicators of Public Debt 2012-2032

	Projections							
	2012	2013	2014	2015	2016	2017	2022	2032
PV of Debt-to-GDP Ratio								
Baseline	66	69	71	72	73	73	70	63
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	66	68	70	72	73	75	78	83
A2. Primary balance is unchanged from 2012	66	70	73	77	80	83	93	110
A3. Permanently lower GDP growth 1/	66	69	73	75	76	77	82	97
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	66	71	77	79	80	81	83	82
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	66	69	73	74	74	75	72	64
B3. Combination of B1-B2 using one half standard deviation shocks	66	69	73	75	76	76	75	70
B4. One-time 30 percent real depreciation in 2013	66	84	85	86	86	85	80	69
B5. 10 percent of GDP increase in other debt-creating flows in 2013	66	75	77	79	79	79	76	67
PV of Debt-to-Revenue Ratio 2/								
Baseline	201	215	223	226	228	229	220	197
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	201	212	219	225	230	234	245	261
A2. Primary balance is unchanged from 2012	201	218	230	240	249	258	291	343
A3. Permanently lower GDP growth 1/	201	217	226	233	236	241	253	294
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	201	221	237	243	247	251	256	253
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	201	217	228	232	233	234	225	201
B3. Combination of B1-B2 using one half standard deviation shocks	201	217	228	233	236	238	234	219
B4. One-time 30 percent real depreciation in 2013	201	264	268	269	268	268	250	217
B5. 10 percent of GDP increase in other debt-creating flows in 2013	201	235	243	246	247	248	239	211
Debt Service-to-Revenue Ratio 2/								
Baseline	10	13	13	14	15	15	15	14
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	10	13	13	14	15	15	15	16
A2. Primary balance is unchanged from 2012	10	13	13	14	15	15	16	20
A3. Permanently lower GDP growth 1/	10	13	14	15	15	15	16	18
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	10	13	14	15	16	16	16	17
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	10	13	13	14	15	15	15	15
B3. Combination of B1-B2 using one half standard deviation shocks	10	13	14	15	15	15	15	15
B4. One-time 30 percent real depreciation in 2013	10	14	16	18	18	18	19	19
B5. 10 percent of GDP increase in other debt-creating flows in 2013	10	13	14	15	15	15	15	15

Sources: Country authorities; and staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.

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IMF Executive Board Concludes 2012 Article IV Consultation with Samoa

On June 15, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Samoa.[1]

Background

The Samoan economy continues to recover, but the rebound has been weak. After two consecutive years of contraction, real GDP expanded by 2.0 percent in 2010/11, on account of fiscal and monetary stimulus as well as swift post-tsunami reconstruction. However, growth slowed considerably in the last quarter of 2011, to 0.8 percent, and is expected to remain subdued for the rest of the year as reconstruction activity continues to subside and the growth of external demand remains moderate.

Inflation has been rising in recent months largely as a result of drought conditions in late 2011 that have affected the supply of agricultural products. After peaking at 11.4 percent (4 percent excluding food) in December 2011, headline inflation fell back to 6.7 percent in April and is expected to be around 6 percent by end-June.

The fiscal deficit has fallen to 6½ of GDP in 2010/11 after increasing to 7½ of GDP in 2009/10 to support post-tsunami reconstruction. The implementation of the 2011/12 budget is broadly on target, but supplementary appropriations will likely result in a fiscal deficit of 6 percent of GDP, about ½ percent of GDP higher than originally budgeted and slightly lower than the level achieved last year. Increased deficits have been largely financed by external borrowings on concessional terms.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

The current account deficit has widened sharply over the past three years. This has resulted from increased imports for post-tsunami reconstruction, rising world food and fuel prices, and the slow recovery of remittances and tourism. As reconstruction activity winds down, however, the current account deficit is expected to trend downward (as percent of GDP). Foreign reserves have declined to about US$151 million (about 4.3 months of next year's imports) at end March.

The Central Bank of Samoa has maintained an accommodative monetary policy to support economic activity since the global financial crisis. Banking sector liquidity has tightened considerably following recent dividend repatriation, outbound FDI, and large one-off imports. Banks are generally well capitalized and profitable, but non-performing loans are rising for some banks amid weak economic activity, particularly in the tourism industry.

Executive Board Assessment

Executive Directors commended the authorities' management of the shocks arising from the global financial crisis and the 2009 tsunami. They welcomed the continued economic recovery but noted that growth is likely to remain moderate and is subject to downside risks from global economic uncertainty. As a small island economy, Samoa will also remain vulnerable to exogenous shocks. Against this backdrop, Directors agreed that the focus should be on rebuilding fiscal and external buffers, while supporting the recovery and fostering sustainable growth over the longer term.

Directors welcomed the authorities' commitment to reduce the fiscal deficit, and stressed that decisive actions are needed to achieve consolidation goals and bring public debt to a more sustainable level. Given the fragile state of the recovery, Directors considered that consolidation should be measured and steady in the short run. They encouraged the authorities to restrain current expenditure and to prioritize development and infrastructure projects. Directors called for a credible medium term fiscal consolidation plan with a corresponding debt management strategy. They emphasized the importance of monitoring closely the debt incurred by public enterprises and minimizing fiscal risks.

Directors noted that the tala has appreciated substantially in real effective terms over the past decade and is assessed to be overvalued. Most Directors considered that a gradual realignment of the exchange rate could help prevent further reserve losses and strengthen export competitiveness. A few Directors, however, were not convinced of the benefits of such a move. Directors cautioned that the pace and timing of a realignment would need to be carefully managed, with due consideration to the potential impact on external debt and inflation. They stressed the need for further analytical work, supported by Fund technical assistance, in this area.

Directors agreed that monetary policy could remain accommodative at the current juncture given weak economic activity. The authorities should nevertheless be ready to tighten monetary policy in the event of an exchange rate adjustment. Directors called for continued efforts to strengthen financial sector supervision, in particular by bringing the Unit Trust of Samoa under the oversight of the central bank.

Directors agreed that continued structural reforms would be vital to restoring Samoa's strong growth record. They encouraged the authorities to undertake bold reforms, focusing on increasing the efficiency of public enterprises, further improving public financial management, making customary land more accessible for productive use, and deepening financial intermediation.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Samoa: Selected Economic and Financial Indicators, 2006/07–2012/13 /1

Population (2008): 0.18 million
Main Exports: Tourism, Fish
GDP per capita (2010/11): US$ 3,472
Quota: SDR 11.6 million

	2006/07	2007/08	2008/09	2009/10	2010/11 Est.	Proj. 2011/12	Proj. 2012/13
				(12-month percent change)			
Output and inflation							
Real GDP growth	1.8	4.3	-5.1	0.4	2.0	1.5	1.9
Nominal GDP	9.0	9.7	-2.3	1.9	4.3	8.1	3.9
Change in CPI (end period)	8.0	8.9	10.0	-0.3	2.9	6.0	4.0
Change in CPI (period average)	4.7	6.3	14.6	-0.2	2.9	6.5	2.0
				(In percent of GDP)			
Central government budget							
Revenue and grants	36.6	31.2	34.5	36.2	37.5	33.0	31.9
Of which: grants	7.4	5.3	7.8	10.5	9.5	8.1	7.1
Expenditure and net lending	36.0	32.7	38.8	43.6	43.9	39.0	37.0
Of which: Development	9.3	6.6	12.8	18.9	18.0	13.4	12.9
Current balance	4.1	0.4	1.6	1.6	3.2	-0.3	1.6
Overall balance	0.6	-1.5	-4.2	-7.5	-6.4	-6.0	-5.0
External financing	-1.1	0.9	3.1	10.0	5.5	6.8	5.5
Domestic financing	0.4	0.6	1.1	-2.5	1.0	-0.8	-0.5
				(12-month percent change)			
Money and credit							
Broad money (M2)	8.7	14.5	7.7	10.9	-0.8	-2.4	…
Net foreign assets	9.0	14.4	9.2	32.7	-11.6	-7.6	…
Net domestic assets	8.5	14.5	7.1	1.5	5.3	0.1	…
Private sector credit	12.7	6.7	6.5	4.0	6.4	6.2	…
				(In millions of U.S. dollars)			
Balance of payments							
Current account balance	-80.6	-32.6	-18.0	-45.0	-54.7	-81.5	-87.8
(In percent of GDP)	-15.5	-6.5	-3.1	-7.2	-8.6	-11.4	-11.8
Merchandise exports, f.o.b.	12.2	11.2	11.3	13.2	11.8	12.5	12.9
Merchandise imports, c.i.f.	-241.1	-204.3	-251.1	-278.2	-279.1	-331.9	-339.4
Services (net)	81.9	85.8	101.6	100.0	95.1	110.3	104.6
Income (net)	-37.5	-38.0	-19.0	-19.7	-30.1	-28.0	-29.0
Current transfers	103.9	112.8	139.3	139.8	147.7	155.7	163.2
External reserves and debt							
Gross official reserves	80.9	87.6	104.4	175.8	157.6	151.5	146.8
(In months of next year's imports of GNFS)	3.6	3.2	3.4	5.7	4.5	4.2	4.0
External debt (in percent of GDP)	37.1	30.3	45.3	53.6	49.3	53.2	57.1
Public external debt-service ratio (in percent of exports)	5.2	3.9	5.1	2.4	3.8	4.5	7.0
Exchange rates							
Market rate (tala/U.S. dollar, period average)	2.6	2.6	2.7	2.3	2.3	…	…
Market rate (tala/U.S. dollar, end period)	2.6	2.9	2.5	2.4	2.3	…	…
Nominal effective exchange rate (2000 = 100) 2/	97.3	94.9	97.6	97.9	98.0	…	…
Real effective exchange rate (2000 = 100) 2/	101.0	105.6	116.1	111.6	112.5	…	…
Memorandum items:							
Nominal GDP (in millions of tala)	1,330	1,459	1,426	1,452	1514	1637	1701
Nominal GDP (in millions of U.S. dollars)	520	502	572	618	633	714	744
GDP per capita (U.S. dollars)	2,888	2,778	3,151	3,414	3,472	3,893	4,044

Sources: Data provided by the Samoan authorities and IMF staff estimates.

1/ Fiscal year beginning July 1.
2/ IMF, Information Notice System (calendar year).

Statement by Christopher Legg, Executive Director for Samoa and Christopher Becker, Advisor to Executive Director
Jun 15, 2012

The Samoan economy continues to face substantial challenges in the post-Tsunami and world financial crisis environment. Economic growth remains sluggish and the public debt that was accumulated in the aftermath of the natural disaster has now exceeded its medium-term target of 50 percent of GDP. In this context, we note the authorities' full recognition of the policy challenges that lie ahead and their plans to address the need for fiscal consolidation. These plans were already well progressed but further benefited from Staff input during the recent Article IV mission. The Samoan authorities welcomed the Staff assessment and advice, and attach particular importance to obtaining the technical assistance highlighted in the Staff Report to facilitate implementation of key Fund recommendations. The authorities also want to express their appreciation for the frank, constructive, and collegiate approach to the discussions adopted by Staff.

1. Exchange rate and monetary policy

The Central Bank of Samoa has lowered interest rates to near zero in an attempt to stimulate the economy. However, pass-through is constrained by the commercial banks' concern about risk following the recession, and is hindered by an underdeveloped financial market where there is a lagged and only loose link between the policy rate, bank funding costs, and lending rates. As a result, there is only a very small fillip to growth from monetary policy. Commercial banks continue to be deposit funded and set lending rates as a fixed, risk-based, markup on their administratively determined funding costs. Lending rates have therefore not fallen by anywhere near as much as the policy rate, or indeed deposit rates.

The real exchange rate has appreciated, principally as a result of two significant import price shocks that fed directly into domestic inflation. As a result, there has been a loss of international competitiveness in the tourism and agricultural sectors. The Staff exchange rate assessment indicates an overvaluation of the real effective exchange rate in the order of 10 to 25 percent.

Should economic conditions deteriorate substantially, the authorities are open to the Staff recommendation to implement a gradual devaluation but remain apprehensive about the timing and practicalities of doing so, and attach particular importance to obtaining technical assistance (as agreed with the Fund) which would be necessary to help work through the many implementation issues involved. These include the preponderance of foreign currency denominated external debt, the continued heavy reliance on imports, and the challenges posed for monetary policy by the associated recommendation that monetary policy should be tightened to head off any resulting upward pressure on inflation. (It is concerning to contemplate how much interest rates might have to rise to create a sufficient domestic output gap in order to lower domestic prices enough to offset the much more important increase in imported inflation, given the limited effectiveness of the transmission mechanism noted earlier. The use of statutory reserve deposits to influence lending rates might be an option.)

Our authorities therefore look to the Fund to follow through in facilitating the technical assistance needed to ensure its advice can be implemented. It will be particularly important to consider the composition of the devaluation among the currencies in the basket to which Samoa pegs.

For instance, it might be possible to engineer a larger devaluation against the currencies that represent the main sources of tourism and other exports, while limiting the devaluation against the currencies in which the majority of external debt is denominated.

It is well understood that addressing a potential overvaluation in the exchange rate will also be important to prevent the depletion of foreign exchange reserves, which could eventually force the central bank to devalue the exchange rate in a manner that might be more disruptive.

2. Macroeconomic conditions

The economy grew by just 2.0 percent in 2010/11 and is expected to post GDP growth of 1.5 percent in 2011/12. Lack of competitiveness as a result of the real exchange rate appreciation could well be a key reason for the more sluggish performance in recent years. More indirectly, the sharp appreciation of the Australian and, to a lesser extent, the New Zealand dollar against the US and euro area currencies are probably responsible for diverting many of the traditional tourists destined for Samoa to the United States and Europe. Furthermore, consumers have shown a general tendency to spend less and save more in developed economies like Australia.

Progress has been made on tackling the issue of land ownership. About 85 percent of land is subject to traditional/communal entitlements, which means that basic property rights are not well defined. Commercial banks are unwilling to lend against traditional land or for housing built on that land. As a result, the government continues to consult widely with land owners and financial institutions in an effort to come up with a framework whereby the lease of customary land can be accepted as collateral for commercial investment.

In line with sluggish domestic economic growth, inflation remains relatively subdued and does not threaten to destabilize the macroeconomic prospects of the country. However, given the high dependence on imports, especially of food and fuel, the inflation outlook remains subject to the possibility of adverse shocks that quickly feed into the domestic price level.

3. Fiscal policy and public sector indebtedness

The authorities recognize the need for fiscal consolidation in order to achieve a more favorable debt position that also builds the appropriate buffers to allow scope for fiscal policy to absorb potential future shocks.

Bringing the budget deficit down from around 6.5 percent of GDP this year to the recommended benchmark will require a sustained effort and a significant commitment to build public consensus. Infrastructure needs and further development will need to be carefully prioritized to ensure that fiscal policy does not place an undue burden on the fragile recovery and that, within the constraints, as many social projects are maintained as possible

Public indebtedness is expected to peak in coming years before gradually declining. The consolidation task is considerable and authorities recognize the need to remain austere for many years to achieve a more sustainable level of debt. One of the issues is that much of the donor support comes in the form of soft loans, which while assisting in the development of local infrastructure, nonetheless adds to the existing debt burden. Again, prioritization of competing donor projects will be important to ensure Samoa gets the maximum benefits without unduly constraining its ability to deploy fiscal policy when needed.

Nevertheless, since most of the debt has been incurred on concessional terms, the servicing burden is relatively benign.

There are some issues concerning the effective coordination of spending and debt management which the authorities are addressing.

4. Financial sector issues

The government has recently set up a new unit trust which has several purposes. Unit Trust of Samoa (UTOS) is open to deposits from residents and would allow Samoans access to a broader and more diversified investment portfolio than simple bank deposits. The deposits would be channeled into domestic investments and, eventually, into overseas assets. Matching Samoan savers with Samoan investors is seen as a worthwhile policy objective which also provides competition to the highly concentrated banking sector dominated by two foreign banks. The deposits taken by UTOS are currently guaranteed by the government for the initial 5 year period.

The trust is currently not subject to prudential supervision but is guided by directives from the Ministry of Finance. The authorities are still working on how this new financial institution is best integrated with the rest of the financial system and expect it to evolve over time.