

*Note: Even by normal Pacific Islands' standards, economic information covering American Samoa is extremely limited.*

### Political Climate

American Samoa has been a Territory of the United States for over 100 years. The only US Territory in the Southern Hemisphere, American Samoa's official territorial status is "unincorporated and unofficial", and not all provisions of the US Constitution relate to the islands. Executive power is vested in the governor who is popularly elected every two years. Under the direction of the US Secretary of Interior, the governor exercises authority and holds the right to veto legislation passed by the bicameral legislature, known as the Fono. American Samoa has a delegate in the US House of Representatives who can vote in committee but not on the floor of the House.

At a meeting of the UN General Assembly in January 2000, the UN accepted American Samoa's proposal of May 2001 to be removed from the list of colonized territories. The Governor sent a resolution to the UN Committee on Decolonisation affirming American Samoa's wish to remain a US territory.

Mr. Tauese Sunia gained re-election at elections held in November 2000. Lieutenant-Governor Togiola Tulafono became acting Governor after the death of Mr. Sunia on March 26, 2003. In elections for American Samoa's delegate to the Federal Congress, Mr. Faleomavaega, after two rounds of voting in November 2002, secured an eighth term in office.

### The Economy

American Samoa's main industries are fish canning, taro, pawpaw, pineapples, livestock, and garments. The two main sources of income are the US government and two fish canneries. The private sector is dominated by the fish processing industry, which employs one-third of the workforce. Canned tuna, which is directed almost entirely to the US market, is produced by two US companies, Starkist and Samoa Packing and is American Samoa's principle export. Tuna-canning plants at Pago Pago process fish from US, Taiwanese and South Korean vessels. American Samoa acquires nearly two-thirds of its imports from the US, while Australia usually meets around 10% of the country's import requirements.

The majority of the employed labour force is located within the service industries. The services sector mainly comprises the government and wholesale and retail trade. Small-scale garments manufacturing was developed in the mid-1990s, however, this

industry was adversely affected following clashes between local and foreign workers.

### The population is growing rapidly

According to the World Bank, the annual population growth rate of nearly 4% during the 1990s was one of the highest in the world. This growth rate remains above 3% and demands on government services are intensifying.

### The public sector is being reformed

American Samoa has a limited economic and tax base. The Government has implemented a range of reforms over the past five years in attempts to reduce persistent budget deficits and achieve a greater measure of financial security for the country. Measures to achieve this have included decreasing the size of the public sector and increasing local taxes. Despite the reduction in public sector workers, the government still employs almost one-third of workers in American Samoa. Attempts have also been made to diversify the economy by encouraging tourism and expanding manufacturing activity. In 2001, American Samoa recorded its first fiscal surplus for twenty years.

### Government seeks to diversify the economy

In 2002, the American Samoan Economic Advisory Commission published a report, outlining proposals for further diversification in the Territory. The Commission identified fisheries and agriculture, telecommunications and IT, manufacturing and tourism as key sectors that can help promote a diverse market economy. The plan seeks to introduce the proposals over a period of five to ten years, with the aim of generating more small to medium size businesses.

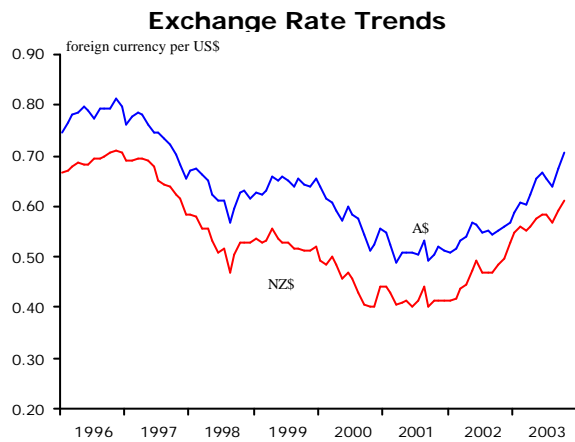
In support of efforts to diversify the productive base of the economy, some businesses are eligible for exemptions from all taxes for periods of up to ten years. The government has strongly supported tourism and the potential for developing this industry seems quite good if constraints related to the costs and lack of air services can be overcome. The government's economic objectives are to increase the islands self-sufficiency and ensure greater participation with the South Pacific region. The economic development aims of the government focus strongly on the expansion of private sector activity and the encouragement of foreign investment with local participation.

## Infrastructure

The quality of infrastructure is generally good with modern telecommunications and one of the best natural harbours in the Pacific. The port has a broad range of facilities and there are good shipping links with the US, Japan, Australia, New Zealand and a number of Pacific Islands.

## Exchange Rates

As a United States Territory, American Samoa uses the US\$ as its local currency. Between end-2002 and October 30 2003, the US\$ has depreciated against both the A\$ and NZ\$, by 24% and 15% respectively.



Source: Datastream

### Political Climate

The Cook Islands is a self-governing country in 'free association' with New Zealand, with a unicameral parliament consisting of 24 elected members serving a term of 5 years. Along with the parliament, a House of Ariki (Chiefs), established in 1966, advises the government on land use and customary issues. A period of government instability followed the last elections in 1999 and between June of that year and January 2003, there were four different governments. The current government, led by Prime Minister Dr Robert Woonton, has held office since January 2003 following the reunification of the two divisions of the Democratic Party and merger with the New Alliance Party. The government is dominated by Democratic Party MPs, and with the backing of one independent has a two-thirds majority. The next election is due in September 2004.

### The Environment

Environmental management is a concern across several sectors. In urban areas, waste management and water supply are inadequate, mainly due to the lack of appropriate cost recovery mechanisms. This presents a serious threat to the health of the urban population as well as to the future of the tourism sector. Consistent with many of its Pacific neighbours, the country is vulnerable to external shocks, cyclones, and irregular sectoral trends.

### The Economy

The Cook Islands suffers from the common development constraints associated with geographical isolation and dispersion of small population centers among 15 islands, limited natural resources and a scarcity in skilled labour. The new government has identified social cohesion and outer island development as priorities.

The Cook Islands' main exports are pearls, fresh fruit and handicrafts while the principal imports comprise capital equipment, basic manufactures and fuel. Tourism, mainly based in Raratonga, accounts for around 40% of GDP and is the main industry in the Cook Islands. The tourism sector prospered in the late-1980s and early 1990s. However, in recent years, the industry has been adversely impacted by the collapse of the airline Canada 3000, although tourist growth resumed in the second half of 2002 and the outlook for the industry remains positive.

Pearl production is the Cook Islands' chief export and is focused on the northern group atolls of Manihiki and Penrhyn. The black pearl industry accounts for the vast majority of the Island's exports. However, the industry is facing

problems with marketing and selling its products, although earnings are expected to increase over the next few years.

Economic growth slowed to 0.3% in 2002, following 2 years of healthy growth. Total merchandise exports fell from US\$9.5 mn in 2001 to US\$5.8 mn in 2002, largely due to an almost 50% drop in sales of pearls. GDP is forecast to grow by 1.5% in 2003 and by around 3.0% the following year. These projections assume stronger growth in tourism and pearl exports as well as public and private construction activity.

In 1996, the Cook Islands economy was on the verge of bankruptcy. Poor financial management, persistent budget deficits and a heavy public debt burden had drained government resources, leading to a default on debts to Nauru and the Asian Development Bank (ADB). The economic structure of the Cook Islands economy required reform and, with support from the ADB, embarked on an Economic Restructuring Program. The program focused on reform of the public service, the sale of state assets, the stimulation of private sector-led growth and the strengthening of financial and economic management. As well as this, the country's tax regime was overhauled. The reforms have been relatively successful and have led to more effective economic management.

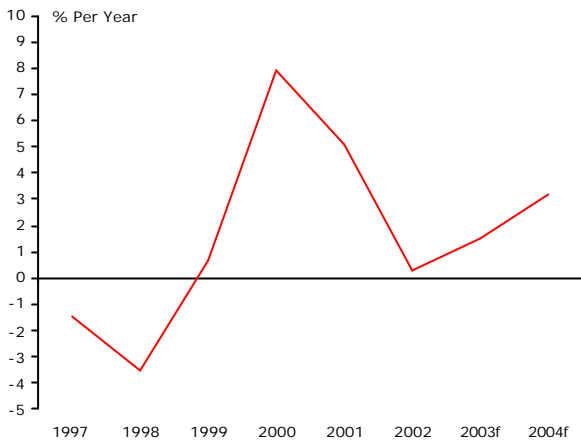
Inflation soared to over 9% in 2001, due largely to the 8.5% depreciation of the NZ\$ (the currency used in the Cook Islands) against the US\$. However, as a result of the general economic slowdown, average inflation declined to 3.9% in 2002. According to the ADB, average inflation is expected to stay in a 3-4% range in 2003.

#### Economic Data

	1999	2000	2001	2002	2003f
Real GDP Growth	0.7	7.9	5.1	0.3	1.5
Average CPI Inflation	1.3	1.7	9.4	3.9	3.4
Current Account Bal. (% of GDP)	-2.2	-2.6	6.3	6.3	5.9
Budget Balance (% of GDP)	-2.4	-1.9	1.5	0.3	N/A

Sources: Economist Intelligence Unit, Asian Development Bank, IMF.

### Growth Rate of GDP



Source: Asian Development Bank

### Tax Reform

In 1998, the OECD included the Cook Islands on a list of 15 countries that engage in harmful tax practices. In response, and in line with the Economic Restructuring Program, the Cook Islands has committed to cooperate with the OECD to improve the transparency of its tax and regulatory systems and establish effective exchange of information for tax matters with OECD countries. Legislation, such as the establishment of the Financial Services Commission, has been implemented to regulate and supervise the financial service industry.

### The Budget

In 2002, the budget was in surplus by 0.3% of GDP, a drop from a surplus of 1.5% of GDP in 2001. Non-tax revenue decreased by 10.5%, while a 4.9% increase in tax revenues and a 10.4% rise in grants raised total revenues and grants by 3.6%. On the expenditure side, the 6.6% increase in total expenditures was driven by a 9.2% rise in expenditures on goods and services, while capital expenditures fell by 9.0%.

The 2003 budget projects a small operating surplus of 2.6% of GDP, but the ADB anticipates a likely deficit, due mainly to higher capital expenditures and a new superannuation scheme for members of parliament. Although recent budgets have helped consolidate the fiscal position, fiscal sustainability is fragile considering debt remains substantial (with principal repayments increasing in the coming years) and the economy is small and heavily reliant on tourism. Any weakening of economic growth quickly has an impact on government revenues and the fiscal position.

### Investment Climate

The Cook Islands is endeavoring to diversify its economy. Priority has been given to the development of the marine resources contained

within the Cook Islands' large Exclusive Economic Zone (EEZ), including black pearl farming in the Northern Group of Islands, as well as expanding its longline fishing capacity in tuna and bellfish. Private sector investment is further encouraged by a loan from the Government to the Bank of the Cook Islands to support commercial longline fishing. So far, many private operators have invested strongly and purchased new vessels, greatly expanding the fishing fleet. Growth in the fishing industry is expected to continue into the medium term and has the potential to reap significant economic gains.

As with the fisheries industry, planned large-scale development in the tourism industry will require significant foreign investment and management. The Government's budget policy statement for 2003 noted that more emphasis is required both to protect business areas reserved for Cook Islanders and to ensure that major foreign investments have local partners.

### Balance of Payments

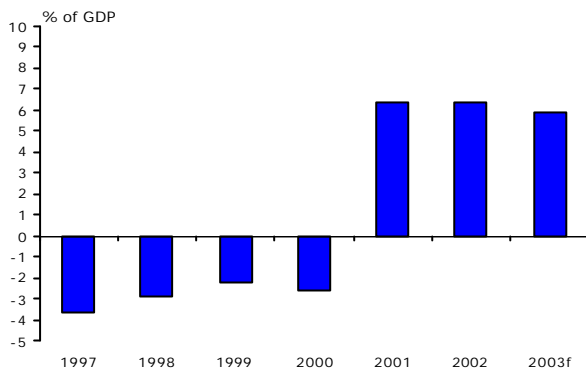
#### Direction of Trade - 2001

Exports		Imports	
Japan	37.5%	NZ	74.8%
Australia	29.1%	Fiji	11.2%
US	13.1%	Australia	6.0%
NZ	8.7%	US	1.4%

Source: Department of Foreign Affairs & Trade, Australia

A steep fall in total merchandise exports was recorded in 2002, stemming largely from a 60% drop in pearl exports in early 2002. Imports declined in 2002 by 8.8% to US\$46.3 million, primarily due to a decrease in imports of minerals and fuels, beverages and tobacco, as well as machinery and transport equipment. The visible trade deficit narrowed slightly from US\$41.2 million in 2001 to US\$40.5 million in 2002. Increased foreign exchange earnings from tourism, private remittances, and development assistance from Australia and New Zealand has, however, helped to offset the trade deficits, with the Cook Islands enjoying current account surpluses since 2001.

## Current Account Balance



Source: Asian Development Bank

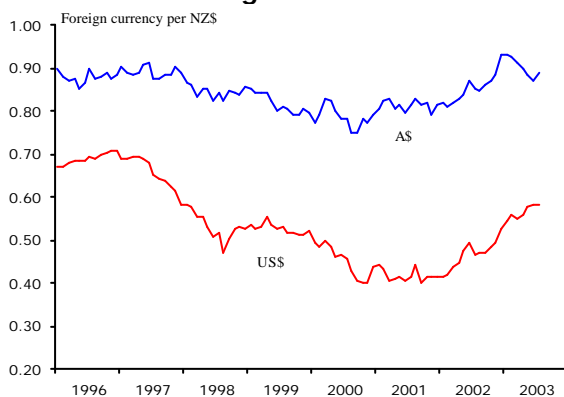
The Cook Islands has signed the Pacific Islands Countries Trade Agreement (PICTA) and the Pacific Agreement on Closer Economic Cooperation between PICTA signatories and Australia and New Zealand. These are expected to provide a catalyst for further tariff reform.

The external debt-servicing burden has eased following a debt restructuring agreement concluded in September 1998 with Italy, Nauru and New Zealand. Debt write-offs and concessions have reduced the foreign debt and lifted a huge burden from the Cook Island's economy. Debt servicing remains manageable provided that the fiscal stance remains prudent and economic growth continues.

## Exchange Rate

Between January and August 2003, the NZ\$ has appreciated by 15% against the US\$, but depreciated by around 6% against the A\$.

## Exchange Rate Trends



Source: Datastream

## Political Conditions

Ethnic tensions and overall political instability mark Fiji's recent political history. In July 2003, the Supreme Court ruled that the Indian-dominated Fiji Labour Party (FLP), led by Mahendra Chaudhry, must be represented in the Cabinet. The decision comes amidst an ongoing power struggle between the FLP and the governing party, the Soqosoqo Duavata ni Lewenivanua (SDL) or Peoples Unity Party, led by Laisenia Qarase. It was hoped that the long-awaited Supreme Court ruling would ease political uncertainty in Fiji, however, Mr. Chaudhry rejected Mr. Qarase's offer of 14 junior seats in an enlarged Cabinet and the post-2000 political impasse seems to be protracting.

Political stability is vital to future economic growth. Current uncertainty concerning land-leases and the future of Indian tenant farmers is at the forefront of racial tension that has hampered economic growth and deterred private investors. In 1997, thirty-year leases for farmers began to expire and Indian tenant farmers are being removed from Fijian-held property. The fate of Indian tenant farmers and the land-tenure issue is a high political priority for the government.

## Economic Data

	1999	2000	2001	2002	2003f
GDP Growth	9.5	-3.2	4.3	4.4	5.1
CPI inflation (avg. per year)	2.0	1.1	4.3	0.9	4.0
Budget Balance (% of GDP)	-0.6	-3.4	-6.5	-7.0	-5.9
Current Account Bal. (% of GDP)	-4.5	-6.3	-3.6	-5.0	-3.7
Foreign Reserves (US\$ mn)	402.6	386.5	341.5	331.5	N/A

Sources: Economist Intelligence Unit, Asia Development Bank, Reserve Bank of Fiji.

Real GDP rose by an estimated 4.4% in 2002, largely driven by wholesale and retail trade (which benefited from strong consumer spending), as well as growth in the transport and construction sectors.

The economy was sluggish in the first quarter of 2003, the result mainly of a decline in tourist numbers and overall global economic weakness. Nevertheless, consumer spending has continued to be strong and, coupled with increased visitor numbers, the economy recovered in the second quarter. Barring a further increase in political instability, the medium looks favourable for the Fijian economy, with the Asian Development Bank (ADB) projecting health growth in 2003 and 2004.

The increase in headline inflation from 1.6% in December 2002 to 4.7% in September 2003 mainly reflected an increase in Value-Added Tax (VAT) - from 10% to 12.5% - in January 2003, which pushed up the price of food, household durables, alcohol and tobacco. The Reserve Bank of Fiji expects an average headline inflation rate of 4% for 2003, followed by a fall in 2004 as the impact of the rise in VAT passes.

## Government endeavours to reduce debt

The government maintained an expansionary fiscal stance in 2002, with the budget deficit increasing to a substantial 7.0% of GDP, from 6.5% the year before. The recent VAT increase is designed to increase the government's revenue base and assist its effort to reduce the revenue shortfall. The government has planned to cut the deficit to 4% of GDP in 2003, however, the Reserve Bank of Fiji anticipates a budget deficit of 5.9% for 2003. Nevertheless, over the medium term the projected economic expansion should stimulate a further improvement in the government's fiscal balance.

The 2004 budget was presented in November 2003 and aims to reduce the deficit to 3.5% of GDP. In order to meet this target, the government emphasised the need for greater control of expenditure by improving adherence to planning processes. The 2004 budget is based on a 1% reduction in total expenditure and a 20% cut in capital spending. The spending split in 2004 is expected to be 82% on operating expenditure and 18% on capital expenditure, but the government reiterated its target of achieving a 70:30 spending mix by 2005. The government also emphasised the need for further structural reforms to make the economy more efficient and plans to be more assertive in implementing specific measures with the overall environment for reform assisted by the recent improvement in economic growth.

## The sugar industry continues its decline

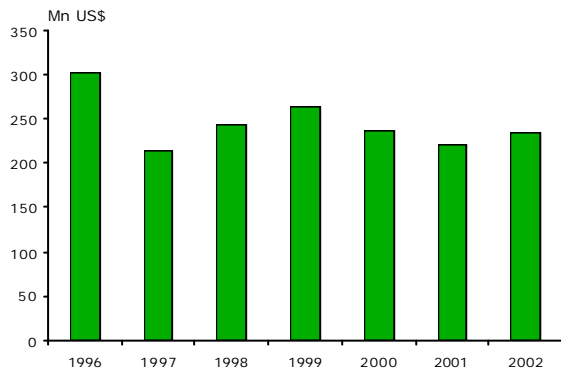
Apart from tourism, sugar is the biggest industry in Fiji, directly employing around one-quarter of the population. However, the industry is facing problems as Indians are barred from owning land and there is uncertainty over the renewal of leases. Additionally, high production costs (US\$28 per tonne, compared to US\$5-6 per tonne in Australia and Brazil), have undermined the sector's prospects.

Further restrictions on growth in the sector have resulted from the cane payment system - a system based on quantity rather than quality - and financial problems of the state-run Fiji Sugar Corporation, which has lost around FJ\$40

mn in each of the past two years. The future of the sector is placed in further doubt as the preferential treatment in sugar exports Fiji receives from the EU is endangered by Australia's challenge at the WTO against EU sugar subsidies. Approximately half of Fiji's exports of sugar go to the EU.

In its budget for 2003, the government has allocated funds to help revive the industry by restructuring the Fiji Sugar Corporation, creating four stand-alone companies answerable to their respective stakeholders. Restructuring will involve upgrading the mills and improving the transport and handling systems.

**Sugar Export Earnings**



Source: Reserve Bank of Fiji

**Investment remains at low levels**

After peaking at almost 30 per cent of GDP in the late 1970s and early 1980s, investment fell to an all time low of 10 per cent in 2000. Investor confidence has been low in recent years and private sector projects have been held back due to political and land tenure uncertainty.

In addressing these concerns, the Fijian government is committed to making the investment environment more attractive. The government is working toward maintaining macroeconomic stability, and implementing structural reforms to promote competition.

**Government is keen to the diversify economy**

The government is attempting to diversify the economy, in order to reduce the reliance on the agriculture sector (especially sugar crops), which is vulnerable to harsh weather conditions. Encouragingly, growth in 2002 was relatively broad-based. The implementation of tax-free export zones in order to promote the manufacturing industry is an example of the government's diversification agenda.

Fiji has a comparative advantage in providing skilled labour to private investors. Fiji is the

South Pacific Islands communications and transport hub. The hosting of the South Pacific Games in June 2003 further enhanced its status as a regional centre. Fiji has world standard air and road links and a well-educated population with English as the official language.

**Tourism is vital to the Fijian Economy**

The tourism sector is the key to the diversification of the economy. Apart from being the country's chief source of foreign exchange, the tourism sector contributes around 20% of GDP. The industry has recovered well from the steep decline in visitor numbers that followed the political instability of mid-2000.

In 2003, the war in Iraq and the SARS virus adversely impacted visitor arrivals early in the year. However, the industry has rebounded strongly and in August 2003, visitor arrivals were up 5% on the corresponding period in 2002, according to the Reserve Bank of Fiji. The strength of the recovery in tourist arrivals is such that, based on current trends, visitor arrivals in 2003 are likely to surge to a record level. Furthermore, it is anticipated that visitor arrivals will increase 2004.

The Fijian government realizes the importance of the tourism sector and the 2003 budget provides marketing grants totalling FJ\$13 mn to the Fiji Visitors Bureau, as well as funds for infrastructure projects.

**Balance of Payments**

**Fiji's Direction of Trade - 2001**

Exports		Imports	
US	28.6%	Australia	43.8%
Australia	19.6%	NZ	14.7%
UK	10.6%	Singapore	8.4%
Japan	5.1%	Japan	3.8%

Source – Department of Foreign Affairs and Trade, Australia

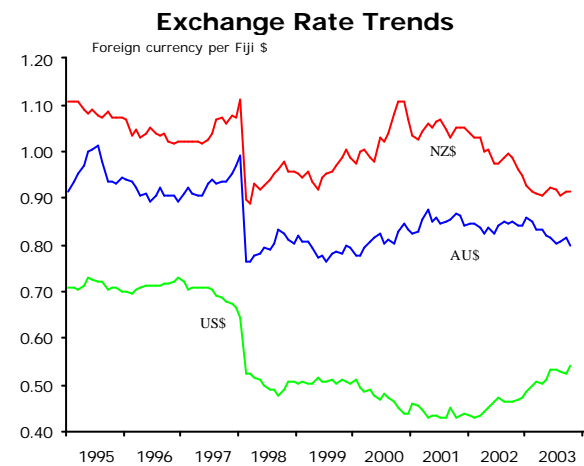
In 2002, there was a 3.6% increase in overall exports, reflecting the continuing recovery in gold exports. Increased imports of minerals, machinery and transport equipment and fuels, led to a 9.8% rise in overall imports. As a result, the visible trade deficit widened and coupled with increased investment income outflows, the current account deficit increased to 5% of GDP, from the 3.6% of GDP recorded in 2001.

At end-May 2003, overall exports have increased by 8% on the year-earlier level. This rise was largely the result of higher earnings from clothing exports, as well as higher

international prices for sugar. Imports at end-May were up 17%, reflecting increased demand for consumption goods and machinery and transport equipment.

### Exchange Rate

Between end-2002 and end-September 2003, the FJ\$ has depreciated against the A\$ by 6.5%, while appreciating against the US\$ by around 12%. In 1997/98, the Asian financial crisis led to the depreciation of many currencies in the Asia-Pacific, placing competitive pressure on the Fijian currency. The FJ\$ was subsequently devalued by 20% in January 1998. At end-September 2003, the FJ\$ was valued roughly at the same level as it was in January 1998 after the devaluation.



Source: Datastream



## Political Climate

Kiribati is a parliamentary democracy within the Commonwealth. The country has a 42 member unicameral parliament, known as the Maneaba ni Maungatabu. Forty members are elected for a four-year term, while a seat is reserved for Banabans living on Rabi Island (Fiji) and the Attorney General sits as a non-elected member of parliament. The President is both Head of State and Head of government. In March 2003, Parliament was dissolved and fresh parliamentary and presidential elections called when recently re-elected President Tito lost power following a vote of no confidence. In the Presidential elections of July, opposition candidate Aote Tong was elected over the government candidate, his older brother Doctor Harry Tong.

## The Environment

Kiribati is made up of 33 islands, of which 32 are only four metres above sea level, leaving much of the country extremely vulnerable to the rising tides expected to result from global warming. New legislation on the environment was enacted in 2002 and Kiribati will continue to work closely with international and regional organizations to secure agreement on environmental initiatives.

## The Economy

Like other Pacific nations, Kiribati suffers from geographical remoteness, a widely disbursed population, and a narrow resource base. The fiscal position and balance of payments show substantial swings from year to year, reflecting the small size of the economy as well as its openness and reliance on "lumpy" items such as external grants and incomes from fishing licenses. Kiribati has abundant ocean resources and relies heavily on license fees from other fishing nations. Other foreign exchange earners comprise copra, live fish and seaweed, as well as remittances from Kiribati citizens employed abroad.

In 2002, GDP grew by 2.8%, up from 1.5% in 2001. The increase was the result of healthy consumer spending, largely a consequence of recent increases in public sector wages and employment provided by construction work on large development projects. The forecast is for GDP to grow at around 2.5% in both 2003 and 2004.

Tourism continues to do well, as does the construction sector. The Government funded many projects in 2002, including the building of a power station in South Tarawa, as well as a rural electrification project. Development expenditure is expected to remain firm over the

medium term as the work on the various infrastructure projects begun in 2002 continues. While this work is currently having a beneficial impact on economic activity, there is a risk that over time this may result in a further enlargement of an already large public sector.

During the first half of 2003, consumer spending continued to stimulate the economy. Additionally, The Bank of Kiribati, as well as the government-run Development Bank of Kiribati, reported strong demand for credit for the creation and expansion of small businesses.

Unemployment and underemployment are major problems. According to the Asian Development Bank (ADB), less than 20% of the working-age population in 2001 is formally employed.

## Economic Data

	1999	2000	2001	2002	2003f
Real GDP Growth	6.2	0.2	1.5	2.8	2.5
Budget Balance (% of GDP)	9.0	12.3	15.0	-5.9	N/A
CPI Inflation (average)	1.8	0.4	6.0	5.1	N/A
Current Account Bal. (% of GDP)	11.4	19.0	4.0	-6.5	1.1

Sources: Economist Intelligence Unit, Asian Development Bank, IMF.

## The Budget

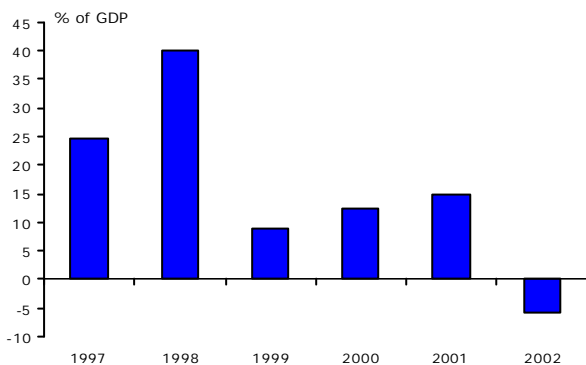
Central government revenues amounted to around 120% of GDP in 2002, lower than the nearly 150% recorded in 2001. Fishing revenues on average account for half of revenues, while the income from the external investments of the Government's Revenue Equalization Reserve Fund (RERF), valued at US\$325 million at end-2002, and local taxes and duties (mainly on wages and salaries, company profits, and imports) provides the other half. The revenue from fishing license fees dropped sharply from a high of \$US52 million in 2001 to US\$32 million in 2002. Government expenditure was around 125% of GDP in 2002, down from the 133% the previous year. Much expenditure went into increases in the public sector wage bill. The overall budget ended with a deficit equal to 5.9% of GDP, a pronounced turnaround from the previous year's surplus of 15.0%.

Since independence in 1979, Kiribati governments have traditionally adopted a cautious approach to domestic spending combined with a deliberate policy of accumulating offshore investments. These offshore investments are a major feature of national resources and source of income for Kiribati. The RERF has increased significantly in recent years, although the global economic

slump and weaker international stock markets resulted in a decrease in its value in 2002.

The RERF provides both an important buffer against fluctuations in revenues and a source of funding for development expenditures. However, Kiribati's substantial reserves through the RERF have not been translated into strong local development. Kiribati has one of the lowest GDPs in the region and its social indicators compare poorly with most other Pacific Island nations.

### Budget Surplus/Deficit



Source: Asian Development Bank

### Investment Climate

The privatization and commercialization process is developing extremely slowly, with political support sporadic. Economic growth has been constrained in recent years by continued infrastructure problems and the lack of progress in creating an attractive environment for private sector investment. There has been almost no foreign direct investment since 2000.

The government is in the process of setting commercial standards for several public enterprises and in formulating strategies for achieving full commercialization and privatization of these enterprises. The Bank of Kiribati is now 75% owned by ANZ Banking Corporation and the government has identified Atoll Motor Marine Services, Tarawa Biscuits, and the Otintaai and Captain Cook hotels for possible privatization.

### Balance of Trade

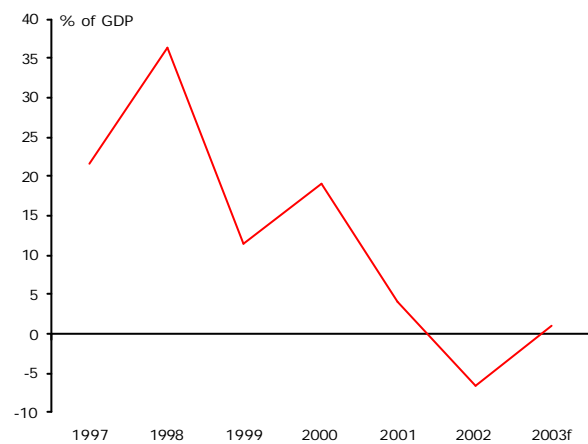
#### Direction of Trade - 2002

Exports		Imports	
Japan	55.9%	France	28.9%
Thailand	16.8%	Australia	26.4%
Korea	13.3%	Fiji	12.6%
US	3.5%	Japan	9.4%

Source – Department of Foreign Affairs & Trade, Australia

Merchandise exports expanded to US\$4.2 mn in 2002, from \$3.8 mn in 2001. The price of copra, the country's main export, rose during the year, although production levels have been down since 2000. Merchandise imports increased to US\$35.9 mn in 2002, from US\$31.5 mn the previous year, due to the increased import infrastructure components and materials, as various government projects moved from the planning to the construction phase. Improved consumer demand also underpinned the rise in imports. With the substantial deficit on visible trade widening in 2002 to 88% of GDP according to the IMF, and a substantial deterioration in the net transfers balance, the current account was in deficit for the first time in 8 years, with a shortfall equivalent to 6.5% of GDP.

### Current Account Balance

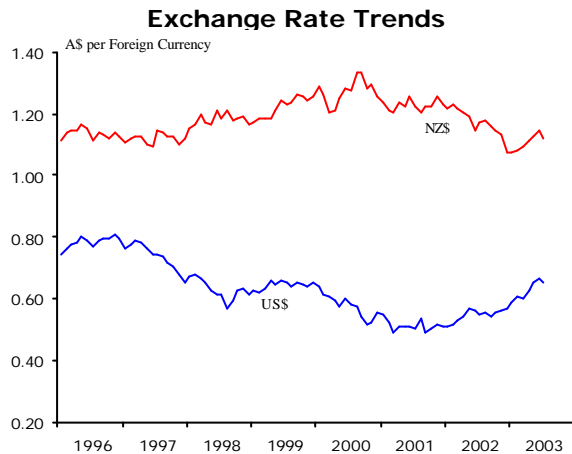


Source: Asian Development Bank

In 2003, imports are forecast to rise slightly to US\$36.6 million, with many imports related to the various infrastructure projects initiated in 2002. The current account balance is expected to post a surplus of \$0.5 million, equivalent to 1.1% of GDP, reflecting increased receipts from services and private remittances.

## Exchange Rate

Kiribati uses the Australian dollar as the local currency and does not operate an independent currency system. Export competitiveness has benefited from the depreciation of the Australian dollar in 2000 and 2001, but the A\$ has recovered since then. After a small rise in 2002, the A\$ appreciated against the US\$ by 24% from end-2002 to end-October 2003.



Source: Datastream

## Political Climate

Papua New Guinea is a Westminster-style parliamentary democracy within the British Commonwealth. The British monarch is the Head of State, and is represented in PNG by a Governor General. The legislative branch is the National Parliament (often referred to as the House of Assembly), comprising 109 members - 89 elected from local electorates and 20 from provincial electorates. Members of the unicameral Parliament are elected by universal suffrage and serve five-year terms and the Prime Minister serves as the Head of Government. The National Executive Council (Cabinet), comprising the Prime Minister and other Ministers determine policy.

On 5 August 2002, Sir Michael Somare was elected Prime Minister for the third time in PNG's history (he was PNG's first Prime Minister upon independence in 1975 and again between 1982-85). The 'Organic Law on the Integrity of Political Parties and Candidates' was implemented in 2002 with the aim of improving political stability by prohibiting the practice of MP's switching political alliances after an election. Under the new law, female candidates are encouraged further and a limited preferential voting system for future elections is considered. General elections in PNG are characterised by fluid party alignments and a high turnover of MP's. Although constantly challenged, Mr Somare's administration appears reasonably stable. On September 18, Sir Albert Kipalan was elected as the new Governor General, replacing Sir Silas Atopare. However, the election process is being disputed and the result is being challenged in the Supreme Court.

## Bougainville

On 30 August 2001, the Bougainville Peace Agreement was signed. The Agreement is an outline for disarmament and an autonomous Bougainville Government. Presently, disposal of weapons is the main objective of the peace process. The Government and local leaders have worked together to amend the constitution to allow greater autonomy to the province and tensions have progressively declined.

## The Economy

PNG's chief exports are gold, crude oil, copper and palm oil, while principal imports comprise machinery, transport equipment, manufactured goods and food and live animals. According to the IMF, more than 85% of the population live in rural areas and rely on subsistence activities.

GDP fell by 3.1% in 2002, the economy's third consecutive year of contraction. This decline was mainly the result of the continued contraction in

the mining and oil sector, which accounts for more than 20% of GDP. However, the non-mining sector benefited from the upsurge in prices for key agricultural commodities (in particular palm oil, cocoa and coffee), resulting in an increase of 2.4% in 2002, after a decline of 4.2% in 2001. In the June quarter of 2003, production levels of copper and gold declined. However, this has been more than offset by the increased international price for gold and crude oil. Apart from copra, the non-mining sector has performed well in the June quarter, recording higher production of all major agricultural and log exports.

As a consequence of the improved outlook for commodity prices and growth in the output of most agricultural commodities, the Bank of Papua New Guinea (BPNG) projects growth of around 2.4% in 2003.

Headline inflation rose to an average of 11.8% in 2002 from 9.3% in 2001. In the March quarter of 2003, the lag effects of the depreciation of the kina pushed the annual inflation rate to a peak of 20.7%, however it declined to 19% in June. The BPNG projects inflation to fall in the second half of 2003, as the kina stabilises.

In 2002, the kina facility rate (KFR) - the key official interest rate - was raised by 2 percentage points to 14%. In 2003, monetary policy tightened further as the BPNG raised the KFR in steps to 16%. However, in August, the KFR was reduced to 15% and it was cut again in October, to 14%. Private businesses are directly impacted by any rise in the KFR, as the commercial banks' benchmark, the indicator lending rate (ILR) tends to move in line with the KFR.

## Economic Data

	1999	2000	2001	2002	2003f
Real GDP Growth	7.6	-1.2	-3.4	-3.1	*2.4
Average CPI Inflation	14.9	15.6	9.3	11.8	13.8
Current Account (% of GDP)	3.9	10.2	9.6	-1.1	N/A
Budget Bal. (% of GDP)	-2.6	-2.4	-3.7	-3.8	** -2.3
Reserves Excl. Gold (US\$ mn)	205.1	286.9	422.6	321.5	340.4 June
Import Cover (Months)	1.4	1.9	3.2	2.4	N/A

Sources: Economist Intelligence Unit, Asian Development Bank, IMF.

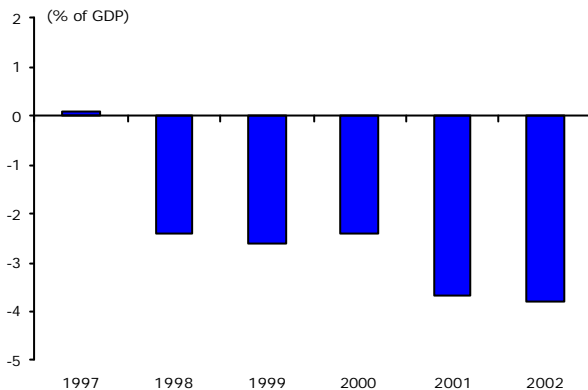
\* Revised Bank of Papua New Guinea (BPNG) projections.

\*\* PNG Treasury Projections at end-September 2003.

## Revenue shortfalls continue to restrict growth

The budget deficit widened further in 2002 to 3.8% of GDP. The Government's fiscal position continues to be a significant constraint on macroeconomic stability and growth.

**Budget Surplus/Deficit  
(% of GDP)**



Source: Asian Development Bank (ADB)

To June 2003, PNG's cash-flow problems have continued. As a result of this revenue shortfall, interest rates on Treasury bills have doubled from the year-earlier level to 20% due to the need for domestic borrowing. The 2003 Government budget expected revenue from asset sales to be Kina200m, but this has not been accomplished. Nevertheless, PNG's Treasurer, Mr Bart Philemon, has stated that he expects the sale of the state's share of Hargy (a palm oil company) and a controlling share in PNG Telikom to be completed.

The 2003 budget attempts to establish a sustainable medium-term fiscal framework. The budget announced new initiatives to help improve private sector confidence, such as tax concessions to the mining and oil sector in an effort to promote exploration.

Attempts to improve fiscal management were also announced in the 2003 budget. For instance, the budget proposed the adoption of a medium-term fiscal framework, which will base the fiscal system on a multiple-year approach, rather than the current single-year platform.

## Land

Customary land accounts for 97% of all land and cannot be bought or sold. The Government recognises that this is a major impediment to economic growth and on several occasions has endeavoured to establish a land registry system. However, popular opposition to land reform has hindered the establishment of a registry.

## Balance of Payments

### Direction of Trade - 2002

Exports		Imports	
Australia	23.7%	Australia	49.3%
Japan	9.3%	Singapore	18.8%
China	5.3%	NZ	4.4%
US	3.2%	Japan	4.2%

Source: Department of Foreign Affairs & Trade

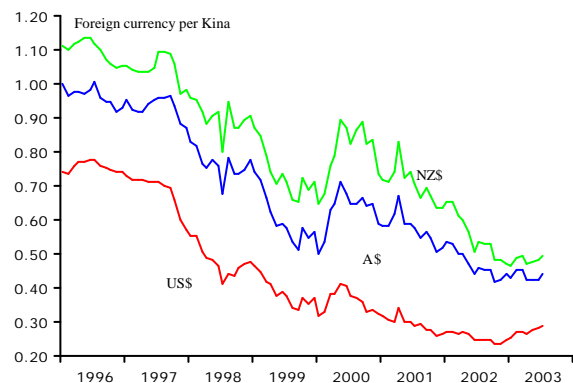
In 2002, total merchandise exports, in US\$ terms, declined by 14.7%, largely reflecting the 24.3% decline in oil exports. Higher international prices pushed gold exports up by 6.5%. In the agricultural sector, exports increased by 35.5%, aided strongly by increased international prices. Log exports increased by 16.5%, largely as a consequence of a delayed wet season that improved access to logging areas.

Total imports increased by 2.3% in 2002, resulting in a decline in the visible trade surplus to US\$591 million, from US\$871 million in 2001. Coupled with increased service payments, the current account recorded a deficit of 1.1% of GDP. However, the Bank of Papua New Guinea (BPNG) projects a surplus of around 5% in 2003, the result of increased production levels and prices for major mineral and agricultural exports.

## Exchange Rate

In 2002, the kina remained reasonably steady against the US\$ due to the Bank of Papua New Guinea's (BPNG) intervention. However, it did not prevent the kina declining by around 18% against the A\$. Between January and August 2003, the Kina appreciated by around 16% against the US\$, while remaining fairly steady against the A\$ and the NZ\$.

### Exchange Rate Trends



Source: Datastream

BPNG's intervention in the second half of 2002 to limit the downward pressure on the kina (by selling international reserves) and the lack of a net inflow of external financing resulted in a marked decline in international reserves, from a peak of US\$439 million at end-June 2002 to US\$321 million by the end of 2002. However, reserves have increased in 2003 and at end-June, stood at US\$340m.

Over the last 5 years to end-2002, the ratio of external debt to GDP has increased from 31.0% to 46.4%, according to the ADB. This has resulted from the decline in the kina and protracted external borrowing.

## Political Conditions

Samoa has developed a robust political system since gaining independence, underpinned by constitutional rule and regular elections. The ruling Human Rights Protection Party (HRPP), led by Tuila'epa Sa'ilele Malielegaoi, has embarked on a rapid economic reform process. This process is far more ambitious than in other Pacific nations. The removal of various business barriers and the lowering of tariffs have been vital to the reform process.

The reform agenda of the government has led to concerns of income disparity between rural and urban areas, which has widened in recent years. Social problems, mainly drug and crime related, have the potential to undermine the positive economic outlook. However, the government is attempting to address income disparity through its Strategy for the Development of Samoa (SDS).

The HRPP has governed Samoa for much of the past twenty years and there is no current threat to its political dominance. The government is utilizing this position to further the reform process by pursuing modernization in the justice system. The government will also review legislation on traditional land ownership, which is a contentious issue in Samoa.

## The Economy

An IMF-supported reform programme has supported the impressive performance of the economy in recent years. This program seeks to reduce the role of government in the economy and to boost the private sector to foster more efficient allocation of resources. The government's reform packages, based on the Statements of Economic Strategy (SES), have increased growth and stabilised the economy. However, growth of over 6% in 2000 and 2001 was not sustained in 2002 as the economy grew by just 1.3%. The weak performance was the result of a downturn in public sector construction and weak exports.

In 2003, the economy remained sluggish in the first quarter, mainly due to lower private remittances, weak exports, in particular fish, and a further decline in private and public sector investment projects. However, agricultural output rebounded markedly and growth should still average around 3% in 2003.

Average consumer price inflation increased in 2002 to 5.5%, from the average rate of 3.8% in 2001. This was the result of the increase in prices of food, transport, cigarettes and beer, and an increase in the value-added goods and services tax (VAGST).

In 2003, the rebound in agricultural output dampened food prices, leading to a decline in the average rate of consumer price inflation from 8.1% in December 2002 to 5.1% in May 2003. Furthermore, the impact of the VAGST will drop out of the consumer price index and inflation is expected to fall to between 3-4% in 2004.

The weighted average interest rates on commercial bank loans fell by nearly 4 percentage points to 11.2% in 2002, while the average interest rate on commercial bank deposits remained at 4.5%, thus narrowing the interest rate spread.

## Economic Data

	1999	2000	2001	2002	2003f
Real GDP Growth	2.6	6.9	6.2	1.3	3.5
CPI Inflation (avg. % per year)	0.2	1.0	3.8	5.5	3.5
Current Account Bal. (% of GDP)	2.2	1.1	-3.1	-0.7	-1.4
Budget Balance (% of GDP)	0.3	-0.7	-2.3	-2.1	-1.7
Reserves – Excl. gold (US\$m)	68.2	63.7	56.6	62.5	N/A

Sources: Asian Development Bank.

## Government policies support growth

The Samoan economy has benefited from numerous reform-minded, growth-enhancing policies. Since the mid-1990s, Samoa has become a more open economy and easier place in which to do business. International competitiveness has been enhanced by tariff and tax reform, along with a more simplified regulatory environment. The tax burden has been reduced through public sector reforms, and the government has also created a predictable and secure investment climate through stable macroeconomic policies and trade liberalization.

In 2001, the government passed the Public Finance Management and Public Bodies Acts, which aim to provide legal frameworks for fiscal spending and the management of state-owned enterprises (SOEs). These steps are in line with the IMF's recommendation to subject state firms to performance-based management. In the second half of 2002, the government sought to develop and implement a program of corporatization and privatization for state-owned enterprises (SOE's).

The government also plans to investigate legislation surrounding the sensitive issue of traditional land ownership. The government's wide reform agenda is advanced further with the new Law Reform Commission, which introduces significant changes to Samoa's justice system.

The Law Reform Commission is charged with streamlining the process of law reform.

## Financial liberalization

The process of financial liberalization was launched in 1998. This process included the abolition of credit ceilings and controls on interest rates. Market-based mechanisms of monetary management have been implemented without undermining macroeconomic stability or hindering the financial position of the central bank. Further developments of the financial sector remain vital to investment and overall economic prospects.

## Investment Climate

The quality and reliability of basic utilities such as government-owned electricity, water, and telecommunications continue to be poor and can constrain business activity. Commercial development is also hampered through availability of land. Communal ownership constitutes roughly 80 percent of land in Samoa. Although the sale of customary land is prohibited, long-term leasing is permitted. However, Samoan law and institutions do not provide for clear enforcement of leaseholder rights and the lease is not considered sufficiently secured to be used as collateral in a financial transaction. Nevertheless, Samoa's investment regime has taken steps forward in reducing barriers of entry to business. The Department of Trade, Commerce and Industry now promote its services as a "one-stop shop" for investors and the government's reform agenda focuses strongly on streamlining the process of obtaining business licenses.

## The outlook for tourism remains positive

Tourist arrivals rose by 5% in 2002 and earnings for the year totaled Tala159.2 mn, 14% higher than in 2001 and more than three times the value of total exports for the year. The sector was boosted by the participation of visitors in various sporting competitions and the 40th anniversary of Samoa's independence.

In 2003, visitor numbers fell in the first quarter as the war in Iraq and the SARS outbreak discouraged people from travelling. In April and May, tourist arrivals started to pick up and at end-September 2003, tourism earnings are up 5% on their year-previous level. Samoa's medium-term economic prospects are expected to be greatly assisted by new investment in the tourism industry, in particular a new hotel development and an overseas marketing campaign.

## Balance of Payments

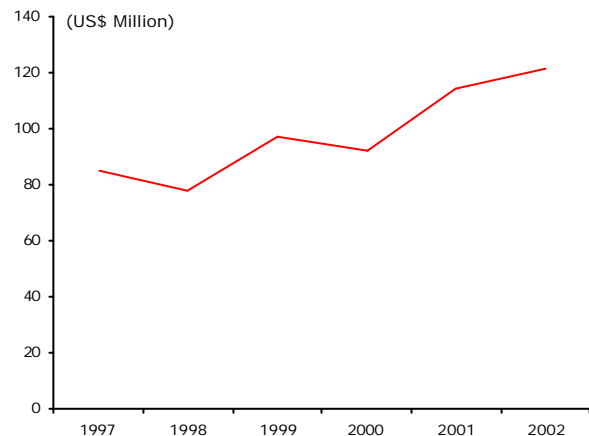
### Samoa's Direction of Trade - 2001

Exports		Imports	
Australia	58.7%	NZ	23.4%
Indonesia	11.5%	Fiji	20.3%
US	8.9%	Australia	15.7%
Japan	3.2%	Japan	12.5%

Source – Department of Foreign Affairs & Trade, Australia

Weak export performance meant that the trade deficit widened in 2002. According to the Central Bank of Samoa (CBS), total exports fell by 9.4% in 2002. This fall, which continued into 2003, was the result of falling export prices and volumes of fresh fish, which, in value terms, accounts for around two-thirds of exports. Garments, Samoa's other main export, declined as a result of weaker demand in international markets. Added to this was the 4.3% increase in the import bill. Exports continued to be weak into 2003, with earnings in February down 12% on the year-earlier level. As well as fresh fish, low earnings and volume from beer and coconut cream contributed to lower export earnings in January 2003.

### Samoa's Trade Deficit



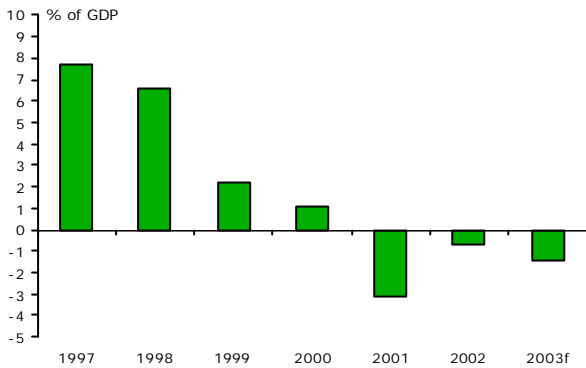
Source: Asian Development Bank

Despite an increase in Samoa's large trade deficit, the current account deficit narrowed to 0.7% of GDP in 2002, from 3.1% in 2001. This was mainly due to strong growth in worker's remittances from Samoans living in New Zealand, Australia and the US. It is estimated that there are more Samoans living abroad than there are living in Samoa and remittances are Samoa's biggest source of foreign exchange. In 2002, workers remittances contributed Tala183 mn, up 22% on 2001. Private remittances, as well as tourism earnings have substantially helped to reduce the current account shortfall. Foreign reserves increased during 2002 and were sufficient to cover approximately 4.5



months of imports by the end of the year. Samoa has a relatively high debt relative to many countries in the South Pacific. However, most of this debt is on concessionary terms and debt service levels remain manageable in the 12-14% range.

### Current Account Balance

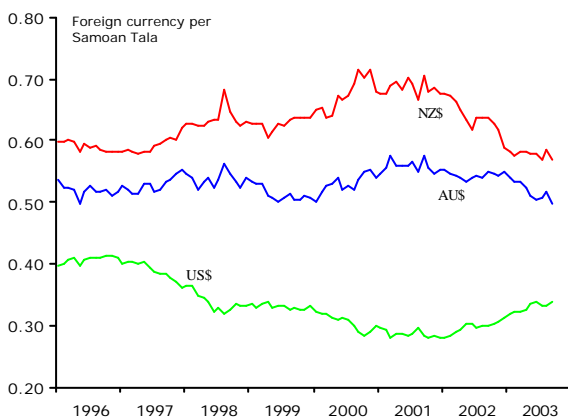


Source: Asian Development Bank

### Exchange Rate

The Samoan Currency, the Tala, is pegged to a trade-weighted basket of currencies, consisting of the A\$, NZ\$, Fiji\$, US\$, and the euro. The Tala depreciated against all the currencies in the basket except the US dollar between September 2001 and September 2002. To end-September 2003, the Tala appreciated against the US\$ by 6%, depreciated against the A\$ by around 9%, and depreciated by around 3% against the NZ\$.

### Exchange Rate Trends



Source: Datastream

## Political Structure

The Solomon Islands has a unicameral national parliament, containing fifty members elected for four-year terms. The Prime Minister (currently Sir Allan Kemakeza) is elected by an absolute majority of members of parliament. Along with the national parliament, there are nine provincial assemblies each led by a premier.

## Ethnic Conflict

Although there had been ethnic tensions before, they intensified in December of 1998. The influence of settlers from surrounding islands (predominantly people from Malaita in search of economic opportunities) on Guadalcanal created conflict, in particular with regard to the occupation of land. The Red Cross repatriated around 20,000 Malaitan settlers as they faced a serious threat from the Guadalcanal militants, the Guadalcanal Revolutionary Army (GRA). However, many returned and concentrated mainly within Honiara, the capital.

By mid-1999, a Malaitan militant group, the Malaita Eagle Force (MEF), emerged and embarked on an armed struggle on Guadalcanal. It was hoped that the Honiara Peace Accord, signed by members of both the national and provincial governments, could resolve the conflict, but the conflict continued throughout 1999. In June 2000, a coup, orchestrated by the MEF and renegade police officers, ousted the then Prime Minister Mr. Bart Ulufa'alu. In October of 2000, the Townsville Peace Agreement (TPA) was signed, which attempted to provide a framework for peace. At elections held in December 2001, Sir Allan Kemakeza's People's Alliance Party was elected under close scrutiny from international observers.

However, the atmosphere of violence and lawlessness weighed down the authorities. From late 2002, extortion and other forms of intimidation directed against the government by criminal groups frequently undermined the effectiveness of the authorities.

Australian and Pacific Islands police and troops arrived in the Solomon Islands on July 24 2003 following a formal request from the Solomon Island's Government. The intervention, titled the Regional Assistance Mission to Solomon Islands (RAMSI) has been relatively successful in gradually restoring law and order to the troubled Pacific nation. On August 13, Guadalcanal rebel leader, Harold Keke, surrendered to Australian forces.

Around 3,000 weapons and 300,000 rounds of ammunition have been handed in by rival militias (as well as the public) under a 21-day amnesty that expired on August 21 2002.

RAMSI police are now patrolling in seven of the country's nine provinces. The Solomon Islands Foreign Minister, Mr. Laurie Chan, hailed RAMSI a success during an address to the UN General Assembly in New York on October 1 2003. The first post-intervention Parliamentary sitting has been earmarked for the end of October.

## The Economy

*Note: The collapse in Government services means that economic data is hard to come by.*

Principal exports in the Solomon Islands comprise timber, fish and cocoa, while chief imports consist of food, raw materials and machinery. Logging remains the principal economic activity and foreign exchange earner, although at a high cost to the environment.

Ethnic violence has plunged the Solomon Islands into economic crises. The economy contracted for the fourth consecutive year in 2002, declining by 4.0% according to the Asian Development Bank (ADB). The ADB calculates a 26% contraction in the economy since 1998. Extensive damage to infrastructure, a decline in private sector activity and government functions has resulted from the political and ethnic crises.

Estimates from the ADB record an annual population growth rate of 3.7% between 1996-2001. Together with the decline in the economy, per capita GDP in US\$ terms has dropped by about half over this period. About 90% of the population are engaged in subsistence economic activity and nearly 90% of land is held under traditional community land-tenure arrangements.

Average inflation was 9.0% in 2002, marginally higher than the 2001 average of 8.0%. In 2003 there has been a surge in imported inflation, resulting in a rise to 14.9% in May. In 2002, average interest rates on commercial bank deposits was 0.6%, while the average lending rate on commercial bank loans was 15.6%

## Economic Data

	1999	2000	2001	2002	2003f
Real GDP Growth	-0.9	-13.3	-10.1	-4.0	N/A
Average CPI Inflation	10.4	8.6	8.0	9.0	N/A
Current Account Bal. (% of GDP)	7.0	-15.9	-15.2	3.0	N/A
Budget Balance (% of GDP)	-4.1	-4.1	-11.5	-12.2	N/A
Reserves Excluding Gold (US\$ Mn)	51.1	32.0	19.3	18.2	N/A
GDP Per Capita (% per year)	-3.6	-15.6	-12.6	-6.7	N/A

Sources: Asian Development Bank (ADB), IMF.

## Government is facing fiscal crises

Macroeconomic stability is jeopardized significantly by the country's poor fiscal position. In 2002, the budget recorded a massive deficit of 12.2% of GDP. The deficit was attributable to problems with both higher than expected wages and salaries and the sharp decline in external grants.

In mid-2000, the donor-sponsored economic reform program was suspended following the political and ethnic instability. Donor support had been providing a vital source of external financing. Since mid-2000, the Government has been unable to pay many employees from the public sector, resulting in strikes by teachers, as well as hospital and airport staff. During this time, the Government has also been unable to meet its domestic debt service commitments, placing the financial sector under extreme pressure.

Now that law and order has been more or less restored, Nick Warner, an Australian diplomat, is charged with the task of eradicating the corruption and financial mismanagement that has plagued the country. Experienced professionals from both Australia and New Zealand will take up positions in important ministries (such as Treasury and Finance) in the coming months. The first post-intervention parliamentary sitting has been earmarked for the end of November, when the state of the Solomons' restructured budget is revealed.

2002, sufficient to push the current account to a surplus of roughly 3.0% of GDP. Even though the overall balance of payments recorded a small surplus, official reserves remain at a critically low level, to cover only 1.5 months of imports of goods and services, according to the ADB.

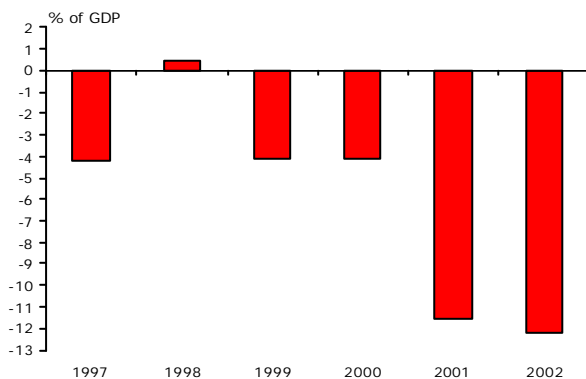
## Direction of Trade - 2002

Exports		Imports	
Japan	21.2%	Australia	31.3%
China	18.7%	Singapore	19.7%
Korea	16.3%	NZ	5.0%
Philippines	9.0%	Fiji	4.6%

Source: Asian Development Bank (ADB)

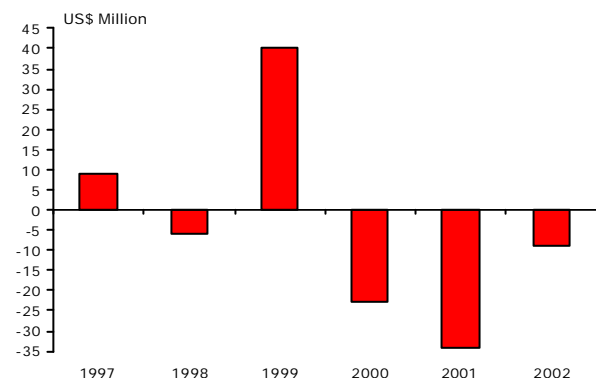
Export earnings have dramatically declined in recent years as Solomon Islands Plantations Limited, a government-owned palm oil producer, was shut down last year. The company employed thousands of people and accounted for around a fifth of the country's export earnings. Furthermore, in mid-2000, the Gold Ridge project, which only began production in mid-1998 and had the potential to produce up to 30% of GDP, was closed. Gold mining and palm-oil production are not expected to recommence in the short term. Exports have become heavily reliant on timber logging, which in 2001 accounted for 77% of total export earnings, up from 64% in 2000.

## Budget Deficit



Source: Asian Development Bank

## Balance of Trade



Source: Asian Development Bank

## Balance of Payments

Exports expanded by 7.7% in 2002, but were still only around one third of their 1999 level. Reflecting the overall weakness of the economy, imports declined substantially by 26.5% in 2002, marking the seventh consecutive annual decline.

As a result of the sharp decline in imports, there was a substantial decline in the trade deficit in

The central government's external debt remains high, and in 2002 amounted to around 79% of GDP. For the past 2 years, the Government has been unable to meet its external debt service payments.

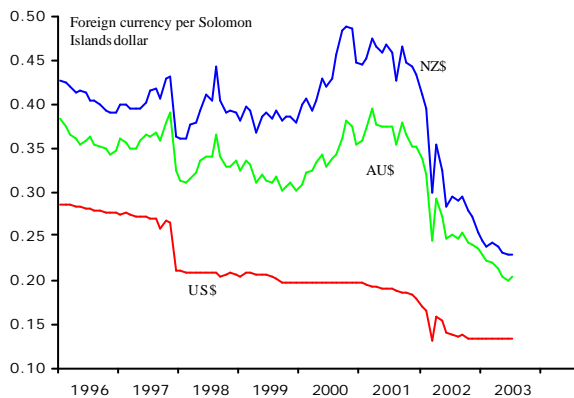
## Exchange Rate

In an attempt to prevent the decline in foreign-exchange reserves, the then Finance Minister Mr. Michael Maina devalued the SI\$ by 25% in

March 2002. However, it seems that the decision to devalue had not received the official approval of the Cabinet. Many members of the government were worried about a projected increase in the cost of living as a direct result of the devaluation. Mr. Laurie Chan replaced Mr. Maina, and subsequently revoked the devaluation.

Nevertheless, the continued poor performance of the economy has meant that the decline in the SI\$ has proven impossible to halt and to the March quarter of 2003, reserves remain at a seriously low level, providing only 2.5 months of import cover. Between March 2002 and August 2003, the SI\$ depreciated by 12% against the US\$, by 34% against the NZ\$ and around 27% against the A\$.

**Exchange Rate Trends**



Source: Datastream

## Political Climate

The Democratic Republic of Timor-Leste is the world's newest nation. The official hand-over of administration from the UN-led force to a locally elected parliament proceeded smoothly in May 2002.

A unicameral national parliament was established, with Members of Parliament elected by popular vote serving five-year terms. For its first term of office, the National Parliament is comprised of 88 members. Following this first term, the national parliament will be limited to a maximum of 65 members. The Head of Government is the Prime Minister, Dr Mari Alkatiri. In May 2002, Mr. Xanana Gusmao was elected President. The President is also elected to five-year terms and is Head of State.

Controlling 55 of the 88 seats, Fretilin (The Revolutionary Front for an Independent East Timor) holds a powerful majority and dominates the Council of Ministers and the Cabinet. Fretilin led the independence movement since its establishment in 1974.

Despite the relatively smooth handover in May 2002, the December riots and arson in Dili, the capital, and violence in Atsabe and Maliana in February 2003 have marred East Timor's first year of independence. Clashes between pro-Indonesian and pro-independence groups resulted in a UN Security Council resolution to maintain the presence of the UN Peacekeeping Force (UNPKF) until May 2004. Many challenges lie ahead for the new nation, as a police force, courts and a parliament have all had to be built from the ground up.

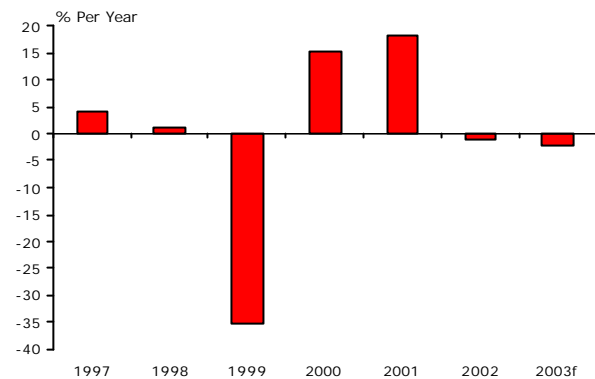
## The Economy

Timor-Leste's economy is essentially agricultural-based. The economy had two years of very high growth in 2000 and 2001 after the devastating violence in the aftermath of the referendum on independence in 1999. GDP expanded by 15.4% in 2000 and by a further 18.3% in 2001. During this period, reconstruction operations and thousands of UN personnel and expatriates with hard currency to spend boosted the economy.

According to the Asian Development Bank (ADB), Timor-Leste's economy contracted by 1.0% in 2002 as domestic demand declined. The reduction in the number of staff from international organizations, along with a decline in UN-funded activities led to this drop in domestic demand.

The most dramatic contraction in the economy in 2002 was witnessed in the construction sector, as private-sector reconstruction activities fell and development project implementation progressed at a slower rate. The gradual reduction of the international presence in 2002 also adversely impacted the services sector, notably restaurant and hotel sales. However, the transport, agriculture and commerce sectors grew in 2002. The ADB anticipates the economy to contract further in 2003, before a modest recovery in 2004. Inflation stood at 1% in 2002, and is likely to edge higher in 2003.

### GDP Growth



Source: Asian Development Bank

According to the ADB, only 6.1% of the labour force is employed in the private, formal sector, while just 3.2% are employed in the public sector. The IMF estimates that over 90% of the population relies on agriculture and subsistence activities. Furthermore, agricultural productivity remains low, standing at around half the level of neighbouring countries.

The world's newest nation ranks among the poorest. Average life expectancy is only 57 years and less than half the population is literate. Unemployment is very high, especially in the main urban centers.

### Economic Data

	1999	2000	2001	2002	2003f
Real GDP Growth	-35.4	15.4	18.3	-1.1	-2.3
CPI Inflation (avg % per year)	140.0	3.0	0.0	1.0	2.0
Current Account Bal. (% of GDP)	2.2	16.5	-1.5	-16.0	-12.2
Budget Balance (% of GDP)	N/A	N/A	-5.6	-8.6*	

Source: Asian Development Bank (ADB)

\* This figure excludes external grants. If external grants are included and the budget is defined in accordance with standard international practice, the budget was in surplus by 3.0% of GDP in 2002, according to the ADB.

The lack of land security has so far deterred foreign investment and bank lending. Different

legal systems adopted through Timor-Leste's history, namely Portuguese and Indonesian regulations, alongside indigenous-based claims, can cause confusion.

### **Timor-Leste has the full support of the international community**

With the assistance of the international community, the government has implemented the National Development Plan (NDP). Numerous international organizations, most notably the IMF, the ADB and the World Bank, along with numerous Non-Government Organizations (NGO's), contributed to the NDP (also called 'Our Nation, Our Future'). The NDP identifies health standards and poverty as areas where critical improvements are needed. A multi-year fiscal framework has supported the NDP, providing for fiscal sustainability.

As a result of the damage caused by the violence in 1999, the country is faced with massive expenditure requirements in the face of limited revenues. Timor-Leste will depend on foreign financial assistance for the next few years until expected revenue from offshore oil and gas development flows through. Oil and gas reserves in the Timor Sea are immense. However, before fiscal year 2005/06 these reserves will only bring modest benefits to the economy.

Timor-Leste receives external assistance through the Trust Fund for East Timor (TFET), as well as bilateral assistance, in particular from Australia, Portugal and Japan. This aid has been pivotal in reconstruction activities and provides much needed technical assistance.

Along with internal revenue collections, the Government's budget is supported by external grants, channeled through the Consolidated Fund for East Timor (CFET). A large share of the CFET is distributed to health and education. The CFET has been marked by large deficits in recent years. There is a lack of access to domestic bank financing and CFET budget deficits have been financed solely through cash grants provided by donors.

The level and efficacy of public sector expenditures will be crucial to Timor Leste's medium-term economic prospects. In June 2003, its development partners evaluated the government's performance. The World Bank's Vice President for East Asia and the Pacific Region, Mr. Jemal-ud-din Kassum, confirmed that Timor-Leste's development partners are particularly impressed with the Government's implementation of the NDP. Mr. Kassum stated that the Government of Timor-Leste has "actively taken up the challenge of transforming resources and assistance into results" and

donors pledged to continue their support for the country.

### **The government seeks to build a diverse economy**

In March 2003, Timor-Leste and Australia signed and ratified the Timor Gap Treaty, which gives East Timor 90% of oil and gas royalties from fields in a jointly owned zone in the Timor Sea. The royalties are expected to channel up to US\$5 billion to Timor-Leste over around 20 years from 2005, provided the proposed developments are implemented.

On November 10, 2003, Australia and East Timor will begin negotiations on a maritime boundary through the resource-rich waters separating them. Both countries declare maritime boundaries that overlap.

Although oil and gas earnings will provide an important financial resource in the medium term, the government is also attempting to promote tourism to diversify the economy. President Gusmao attended the Pacific Asia Travel Association (PATA) Travel Mart in Singapore in early October 2003 to promote East Timor as a tourist destination. Mr. Gusmao expressed the importance for Timor-Leste in finding a 'niche market' to compete with neighboring Australia and Indonesia. At present, the country relies greatly on its only cash crop, coffee.

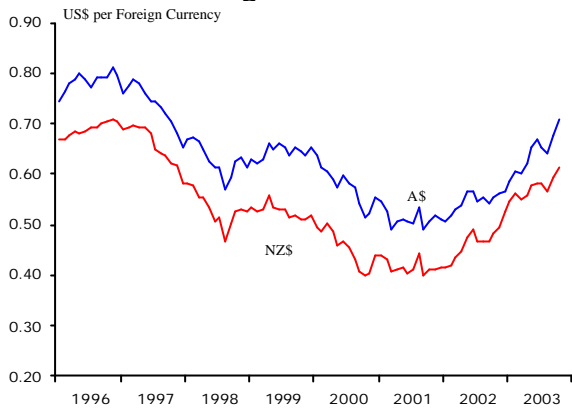
### **Balance of Payments**

In 2002, imports fell by 28.6% due to the decline in domestic demand. Apart from oil, merchandise exports rose by an estimated 25.0%. Despite this, the current account deficit increased sharply in 2002. Coffee is the only notable export and will continue to be its chief source of revenue until income from oil and gas production is realized. Despite being a minor coffee producer by international standards, Timor-Leste benefits from a niche market for its high value, organically grown, mild-washed arabica. Nevertheless, the country's overall exports remain low at around US\$5mn.

### **Exchange Rates**

The adoption of the US\$ has assisted Timor-Leste avoid currency convertibility problems. Until the comprehensive establishment of a central bank and efficient monetary system (there were interim appointments to the governing board of the Banking and Payments Authority of Timor-Leste in 2002), implementation of a national currency is not expected. Between end-2002 and end-October 2003, the US\$ has depreciated against both the A\$ and NZ\$, by 24% and 17% respectively.

## Exchange Rate Trends



Source: Datastream

## Political Climate

Unique in the Pacific, Tonga is a constitutional monarchy. Under its Constitution of 1875, the government consists of the Privy Council and the Cabinet, the Legislative Assembly and the Judiciary. The Privy Council and the Cabinet are presided over by the King who holds both constitutional and executive powers. The Privy Council supports the King in the execution of his functions and is the highest executive authority, consisting of the Cabinet and others the King appoints. The Cabinet comprises the Prime Minister, Ministers and the governors of Tonga's island groups of Ha'apai and Vava'u. In January 2000, the King appointed his youngest son, Prince Ulukalala Lavaka Ata as Prime Minister, replacing Baron Vaea.

There appears to be no significant challenge to the authority of the King, and any future change in Tonga is generally considered to reside with him. Tongan society has historically valued the maintenance of social and political harmony, consensus and tolerance. However, in recent years, the emergence of a more confrontational political atmosphere between the government and its political opponents has challenged this tradition.

## Political Reform

The reformist Tongan Human Rights and Democracy Movement (THRDM) maintained its position at the national elections of March 2002, winning seven of the nine seats. The THRDM calls for a 'democratic monarchy' and seeks to change what it argues to be an undemocratic constitution and government institutions. In addition to criticism at home, the government has faced international criticism emanating from the Privy Council's attempts to ban the pro-democracy newspaper, *The Times*.

Reformists are likely to campaign further for political change when there is a transfer to a new monarch. It is expected that the successor to the 82 year-old King will not be looked upon with the same reverence.

## Land

All land belongs to the Crown and is administered by the Minister of Lands as the King's representative. Land cannot be sold, however, it can be leased.

## The Economy

The economy grew by only 1.6% in 2002, following growth of 0.5% in 2001. The Asian Development Bank (ADB) forecasts growth to increase in 2003 to 2.5% and 2.7% in 2004. The

services sector grew marginally by 0.6% in 2002, a consequence of the poor performance of the restaurant and hotel sectors, sluggish commerce and slow growth in public services. Cyclone Waka, which hit in late 2001 and was the most severe storm to hit the islands in 40 years, reduced the output of root crops in 2002.

Agriculture, with squash pumpkin, vanilla and kava being important export crops, and fisheries are the leading productive sectors. Despite the damage from cyclone Waka, agriculture picked up later in the year and incomes were increased by high prices for squash and vanilla. The country's vulnerability to cyclone damage was further demonstrated by cyclone Ami in January 2003. The damage to root crops such as cassava and yams was minimal, although the cyclone did cause significant damage to fruit-bearing trees and overall earnings from agriculture remain volatile in 2003.

Tourism was weak in the first half of 2002 - the result of fewer airline seats and cyclone Waka. Nevertheless, arrivals picked up in the second half of the year and rose by 11% for 2002 as a whole and the outlook for the tourism industry is improving.

Inflation increased sharply in 2002, averaging 10.4% from 6.9% the previous year, resulting from local food shortages, wage increases, and the further depreciation of the Tongan currency, the Pa'anga. In May 2003, average inflation has further increased to 11.7%. The continuing weakness of the Pa'anga will ensure that inflation remains high in 2003.

## Economic Data

	1999	2000	2001	2002	2003f
Real GDP Growth	2.9	6.5	0.5	1.6	2.5
Consumer Price Inflation	3.9	5.3	6.9	10.4	10.0
Current Account Bal. (% of GDP)	-0.6	-6.1	-9.5	5.5	N/A
Budget Balance (% of GDP)	-0.2	0.7	-0.2	-0.6	-2.9
Reserves	26.8	27.0	26.1	27.7	N/A
Exc. gold (US\$ mn)					

Sources: Economist Intelligence Unit, Asian Development Bank, IMF.

## The government attempts to combat inflation

Monetary policy was tightened in 2002 in an attempt to combat rising inflation and pressures on the balance of payments. Tightening of monetary policy led to the reduction of broad money growth to 7.9% from the very rapid growth of 26.5% in 2001.



The average deposit rate offered by commercial banks declined marginally to 4.6% in June 2002. With the acceleration in the inflation rate, the real deposit rate is negative. Since the mid-1990s, the base lending rate has been stable at 9.0%.

### The Budget

Including grants, total revenues increased by 14.5%, driven largely by a 28.8% jump in trade taxes, while total expenditures rose by 15.7%, due mainly to a sharp increase in the wage bill. The 20% increase in public wages and the rise in subsidies to public enterprises in 2001 have led to a fiscal strain in recent years. The government budget for 2003 is expansionary and the ADB projects a deficit of 2.9% of GDP. This deficit is to be financed exclusively through external concessional funds.

### Public Sector is Reforming

In accordance with the ADB, Tonga has undertaken an Economic Public Sector Reform Program (EPSRP). Ambitious in scope and content, the EPSRP concentrates on strengthening public sector management, enhancing the delivery of basic public services, promoting private sector-led economic growth, and improving financial sector efficiency. The reform process will require sustained political commitment and the government has so far introduced new legislation covering the management of public sector finance and foreign investment. As well as these reforms, the complicated licensing system is being reformed to assist private sector development.

In addition to these developments, Tonga is reducing public sector employment by abolishing 158 existing positions, while not filling a further 425 vacant posts in fiscal year 2002/2003. The government has also embarked on a rigorous assessment of what activities and businesses are best undertaken by the private sector. This process is aimed at reducing subsidies to state-owned enterprises and privatising non-core public operations.

### Tax reform is likely in 2004

Comprehensive tax reform is likely in 2004 and is expected to exempt low income earners from personal income tax and reduce the tax system's dependence on import levies by introducing a broad-based consumption tax.

### Finance Sector

Tonga's financial system is small but has grown with the entry of foreign-owned banks and the economy is considerably monetised. The IMF has called for the urgent recapitalisation of the

National Reserve Bank of Tonga (NRBT), which will enable it to issue Treasury-bills and conduct open market operations. The new Finance Act plans to enhance the NRBT's role and boost its capacity to supervise the financial sector, a move to be financed by increasing the licence fee paid by commercial banks.

### Balance of Payments

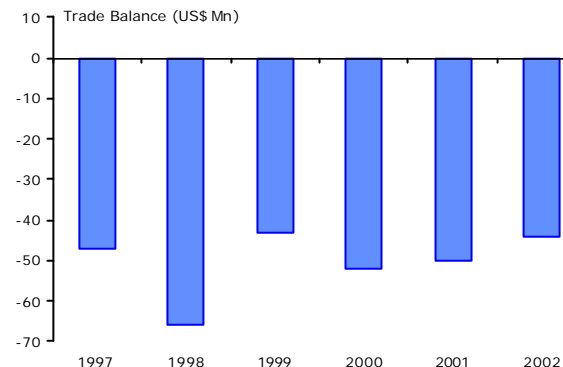
#### Direction of Trade - 2002

Exports		Imports	
Japan	43.2%	NZ	31.5%
US	41.0%	Fiji	21.1%
Greece	3.8%	US	14.6%
NZ	3.6%	Australia	13.5%

Source – Department of Foreign Affairs & Trade, Australia

Exports jumped by almost 50% in 2002, thanks to strong growth in squash and fish exports, whereas imports fell slightly on the back of the sluggish domestic economy. This resulted in a slight narrowing of the massive visible trade deficit, which remained substantial at 33% of GDP.

#### Balance of Trade



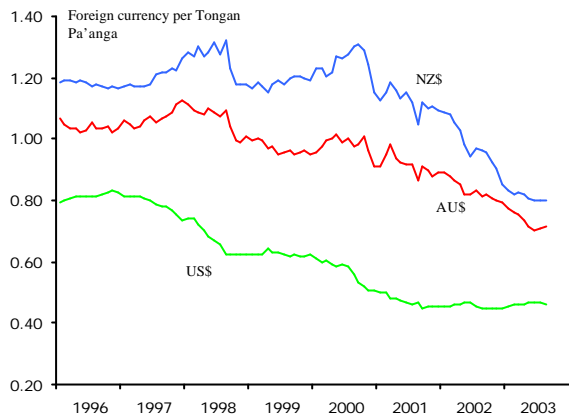
Source: Asian Development Bank

Despite the large trade deficit, a current-account surplus of 5.5% was recorded for 2002. This resulted from an increased level of private remittances from Tongans living overseas, which rose to around 50% of GDP, up from 40% of GDP in 2001. Such remittances are the major source of foreign exchange.

### Exchange Rate

Between end-2002 and end-August 2003, the Pa'anga continued to decline against the A\$ and NZ\$, depreciating by 8% against the A\$ and by 5% against the NZ\$, and remained steady against the US\$. In the past two years, the depreciation of the Pa'anga has assisted Tonga's export competitiveness, although inflationary pressures have also arisen as a result.

## Exchange Rate Trends



Source: Datastream

## Political Climate

The Vanua'aku Pati (VP), led by Prime Minister Edward Natapei, heads a coalition government with the Union of Moderate Parties (UMP), led by Deputy Prime Minister Serge Vohor. Recent attempts to include the opposition National Unity Party (NUP) in the coalition government appear to have receded. The coalition government remains vulnerable as the economy struggles with implementing much-needed reforms. Vanuatu's recent political history has been characterised by weak coalition governments and the frequently changing party alliances have made for a politically unpredictable environment. Despite the uncertain environment, the Natepei government commands a healthy parliamentary majority.

## Environmental Conditions

Vanuatu's vulnerability to earthquakes, cyclones and tsunamis led to the Commonwealth Secretariat ranking Vanuatu as the most vulnerable country to natural disasters among 111 developing countries in 2002.

## The Economy

The economy is narrowly based, relying heavily on tourism, agriculture, and to a lesser degree, financial services. Vanuatu's main exports are timber, copra, beef and cocoa. The vast majority of the population is engaged in subsistence agriculture. In accordance with the Asian Development Bank (ADB) and other aid donors, Vanuatu has embarked on a comprehensive reform program (CRP). The CRP includes measures to improve governance through institutional development, improve service delivery, redefine the role of the public sector and stimulate private sector growth. The current government is committed to the reform agenda.

However, the economy has performed poorly in recent years and reform has not been easy. The economy contracted by 2.7% in 2001 and 0.3% in 2002. The economy has suffered as a result of major cyclones and weak demand, which have negatively impacted the agriculture and tourism sectors. Total arrivals to Vanuatu declined by 7.4% in 2002, while agriculture improved modestly. Copra production grew by 7.1%. However, the forestry subsector contracted by 34% following a similar drop in 2001.

Despite the government's continued commitment to the CRP, growth is expected to yield only modest results in the medium-term. The CRP's medium term annual GDP growth target of 4.5% does not appear attainable. The ADB forecasts economic growth of 1.3% in 2003

and 2.2% in 2004. However, the rapid increase in annual population growth, currently 2.6%, is expected to continue, resulting in the third consecutive year of declining income per head.

Considerable emphasis is placed on the agricultural sector as a means of boosting the economy. Efforts are being made to upgrade the beef industry and improve access to higher value overseas markets for local organic beef. A number of agricultural organisations and industries are also increasing their export potential. For instance, the local company Coconut Oil Production Vanuatu is increasing its ability to store and export coconut oil by building two extra oil tanks at the main wharf. Additionally, the Chamber of Commerce is running a series of workshops to encourage farmers to produce root crops, such as yam, taro, manioc and kumala for export. Added to these developments are considerations for the expansion of the coffee industry.

Vanuatu's commercial banks' interest rate spread is the highest in the Pacific. In 2002, commercial deposit rates eased slightly while commercial lending rates rose on average. Consequently, the interest rate spread widened to 12.0% from 11.3% in 2001. Furthermore, the effective spread is much wider than this due to the general requirement for significant deposits as collateral, which is often financed by further borrowing.

## Economic Data

	1999	2000	2001	2002	2003f
Real GDP Growth	-3.2	2.7	-2.7	-0.3	1.3
CPI Inflation (avg % per year)	4.2	1.9	3.5	2.0	2.5
Current Account Bal. (% of GDP)	-4.8	1.8	-2.3	-2.0	-0.3
Budget Balance (% of GDP)	-1.2	-7.1	-3.7	-2.1	N/A
Reserves Excl. Gold (US\$ mn)	41.4	38.9	37.7	36.5	N/A
Import Cover (Months)	3.2	3.2	3	N/A	N/A

Sources: Economist Intelligence Unit, Asian Development Bank, IMF.

## The government seeks to diversify the revenue base

Following two years of large budget deficits, Vanuatu's fiscal position improved in 2002, recording a narrower shortfall of 2.1%. Although weak growth produced lower than expected revenue, expenditure restraint - particularly financial controls and personnel costs - were significant in improving in the budget balance. Vanuatu has no corporate or personal income tax, acquiring revenue

predominantly from value-added tax (VAT) and customs duties. The introduction of the VAT in 1998 was designed to ease the reliance on tariffs. Nevertheless, the limited revenue base continues to constrain government efforts to deliver services and introduce reforms. Recent measures designed to boost government revenue by directly taxing banking transactions and the introduction of new excise duties has been controversial.

Vanuatu's current dependency on tariff revenues is inconsistent with the prospective introduction of the Pacific Island Countries Trade Agreement (PICTA), which would oblige Vanuatu to establish new revenue sources. Under PICTA, all tariffs would have to be gradually removed by 2016. Although it is yet to ratify the agreement, Vanuatu is a party to the PICTA and parliament have authorized ratification.

### Financial sector is reforming

In April 2002, Vanuatu was included on an OECD list of uncooperative tax havens. However, positive steps were taken throughout the year to address these concerns with the introduction of "know-your-customer" procedures and a new International Banking Act. Passed in November 2002, the International Banking Act places offshore banks under the supervision of the Reserve Bank of Vanuatu from 2003. As a result of these positive steps, the OECD removed Vanuatu from its tax blacklist in May 2003. Combined with more general bank supervision, the reforms of the OFC (Offshore Financial Centre) sector should improve the overall soundness of Vanuatu's financial system.

### Tourism vital to economic growth

Tourism is a major contributor to growth. However, strong competition from Fiji, global security concerns, as well as the more general downturn in tourism in the Asia-Pacific region has caused the sector to struggle. Visitor arrivals were down by 20.1% year on year in March 2003, with cruise ship visitors falling by an even steeper 55.2%. Added to these concerns is a relatively high real exchange rate. To reinvigorate the industry, a meeting was held in March, focusing on improving planning for peaks and troughs in arrival patterns, producing more effective promotional materials, as well as developing more pro-active advertising overseas. The meeting brought together key figures in the tourism industry, from both Vanuatu as well as the principal tourism markets.

It is hoped that the expansion of Australia's budget airline, Virgin Blue, into the South Pacific can reinvigorate the tourism industry. Virgin Blue will begin operations to Vanuatu and other South Pacific destinations by the end of 2003.

### The government is seeking to reduce the high-cost business structure

Compared with most of its Pacific neighbours, Vanuatu has a high cost structure. Apart from New Caledonia and Tahiti, Vanuatu has the highest cost structure in the Pacific. Domestic transport costs are high with the population scattered across numerous well-separated islands. Vanuatu's heavy reliance on tariffs for revenue has resulted in import duties on business inputs that directly raise the cost of production. To correct this, the Natapei government is seeking to enhance the business environment and attract foreign investment. In 1998, a new Foreign Investment Code was introduced, resulting in some improvements in the process of foreign investment approvals, mainly in the tourism, international finance and agricultural sectors.

### Balance of Payments

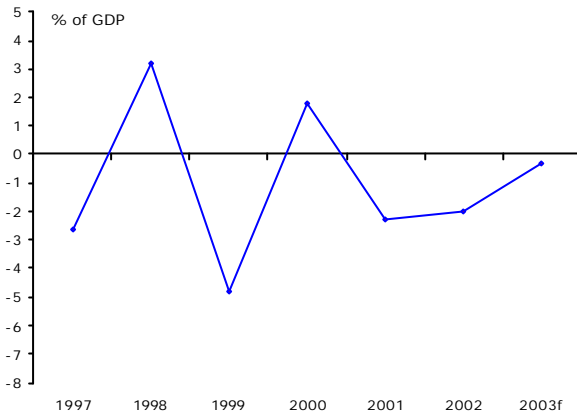
#### Direction of Trade - 2002

Exports	%	Imports	%
India	29.9%	Australia	23.7%
Indonesia	22.4%	Japan	20.6%
Thailand	21.0%	NZ	10.8%
Japan	4.7%	Singapore	8.7%
Australia	3.0%	Fiji	7.1%

Source – Department of Foreign Affairs & Trade, Australia

Exports grew by 7.0% in 2002, while imports increased by 2.9%. Vanuatu has been running a considerable trade deficit since 1998 and according to the ADB, is expected to widen further in 2003 and 2004. Despite this visible trade shortfall, the current account deficit improved marginally to 2% of GDP in 2002 and is forecast to narrow further in 2003.

## Current Account Balance

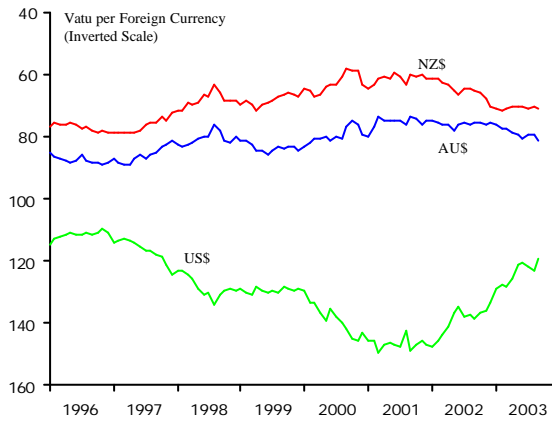


Source: Asian Development Bank

## Exchange Rate

Between end-2002 and end-September-2003, the Vatu has appreciated against the US\$ by 10%, depreciated by 7% against the A\$ and remained steady against the NZ\$.

## Exchange Rate Trends



Source: Datastream



Australia and New Zealand Banking Group Limited is represented in:

**AUSTRALIA by:**

Australia and New Zealand Banking Group Limited ABN 11 005 357 522  
10<sup>th</sup> Floor 100 Queen Street, Melbourne 3000, Australia  
Telephone +61 3 9273 6224 Fax +61 3 9273 5711

**UNITED KINGDOM by:**

Australia and New Zealand Banking Group Limited  
ABN 11 005 357 522  
Minerva House, PO Box 7, Montague Close, London, SE1 9DH, United Kingdom  
Telephone+ 44 171 378 2121 Fax+44 171 378 2378

**UNITED STATES OF AMERICA by:**

ANZ Securities, Inc. (Member of NASD and SIPC)  
6<sup>th</sup> Floor 1177 Avenue of the Americas  
New York, NY 10036, United States of America  
Tel: +1 212-801-9160 Fax: +1 212-801-9163

**NEW ZEALAND by:**

ANZ Banking Group (New Zealand) Limited.  
Level 10 215-229 Lambton Quay Wellington, New Zealand  
Telephone +64 4 496 7000, Fax +64 4 496 7360

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