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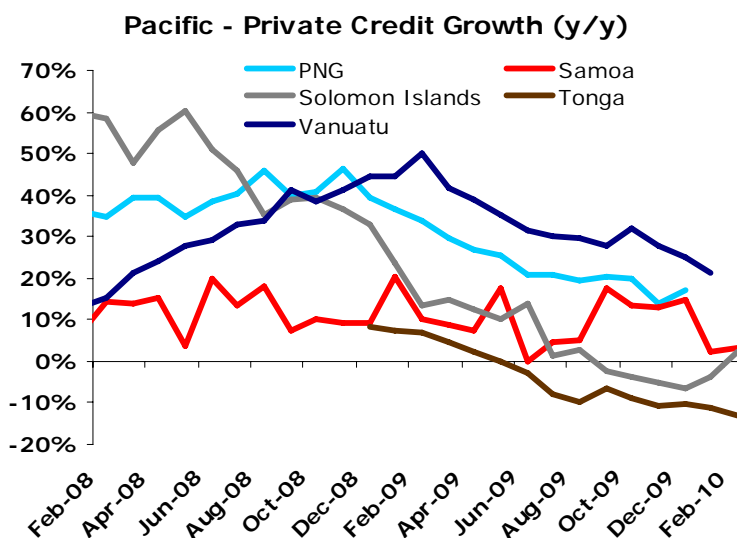
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HIGHLIGHTS

- A recovery has begun to take hold in the Pacific, although it remains uneven across the region:
 - Domestic demand is improving, partly due to base effects.
 - Trade, tourism and remittance flows remain weak in general.
- Although the pace of activity is beginning to recover, inflation remains contained across most of the Pacific.
- Exchange rate developments have been mixed so far in 2010. SBD, VUV and WST have strengthened against the USD. Most Pacific currencies weakened against AUD, which has continued to out-perform.
- In our Feature Note we look at some design issues related to a likely sovereign wealth fund in Papua New Guinea.

Chart Pick: Credit Growth Continues to Decline Across the Pacific



Source: National Statistics Agencies

FEATURE NOTE

A SOVEREIGN WEALTH FUND FOR PAPUA NEW GUINEA — SOME KEY DESIGN ISSUES

The projected revenues from Papua New Guinea's LNG project are enormous relative to the size of the economy, and present a unique opportunity to advance the social and economic development of the nation. But how should these windfall revenues be managed to ensure the benefits flow to the Papua New Guinean people? In this note we set out our thoughts on some key design issues for the sovereign wealth fund now under consideration by the authorities.

BACKGROUND

The mineral sector in Papua New Guinea has been a major contributor to both government revenue and nominal GDP over the past three decades. In the last five years it has contributed about one-quarter of nominal GDP on average; oil and gas, the largest component, has contributed 12%. Existing mines and oil fields are scaling down production as they reach maturity. At the same time, a number of new projects, most notably the LNG project, are progressing to fill the gap.

The LNG project is by far the largest in the country and is expected to bring direct capital investment of about US\$10bn (K36bn) during its 30-year life span. It is also expected to produce a maximum capacity of 6.4 million tonnes of liquefied natural gas per annum when it starts production in the second half of 2014. This is equivalent to about 54 million barrels of oil, much higher than the current oil production.

The LNG project should transform Papua New Guinea's economy in the years ahead. Construction has begun and related activity should bring tangible benefits in the near term. When the project comes on line in late 2014, government analysis shows that it will make a significant contribution to GDP growth (which is forecast at 8.5% that year). The direct impact on the economy will be in the form of government tax revenue, dividend payments and royalty payments.

How should this windfall be managed in order to maximise the benefits to the Papua New Guinean people? The government is giving serious consideration to creating a sovereign wealth fund (SWF) for this purpose. This note sets out our thoughts on key design issues related to a SWF.

QUESTIONS AND ANSWERS REGARDING A SWF FOR PNG¹

Does PNG need a SWF to manage LNG project revenues?

Yes. LNG production will generate windfall revenues over a relatively short period of time which will need to be effectively managed over a protracted period for the benefit of the Papua New Guinean people. A SWF is the appropriate vehicle to facilitate this process, and has been used successfully in other countries enjoying resource-based windfalls—petroleum in Norway, copper in Chile and diamonds in Botswana.

¹ This list is by no means exhaustive. For a more comprehensive coverage of the issues, we refer readers to *Possible Creation of a Sovereign Wealth Fund*, a Discussion Paper by the Department of Treasury and Bank of Papua New Guinea Joint Sovereign Wealth Fund Working Group, dated 16 April 2010.

FEATURE NOTE

What should be the objectives of a SWF?

There are several possible objectives for a SWF, but in our view it should, first and foremost, be a national savings account designed to ensure intergenerational equity. In this model, the SWF accumulates wealth from current LNG revenues and invests and spends the proceeds on behalf of future generations.

As a secondary objective, the SWF should contribute to macroeconomic stabilisation. More specifically, it could help smooth revenue flows from the mineral and resource sectors, which tend to be volatile and potentially disruptive to project spending. As noted below, this system needs to be rules-based and transparent so that SWF disbursements used to smooth resource revenues in lean years are repaid during boom years.

What is the relationship between the SWF and the budget?

The SWF should be fully integrated into the budget and the fiscal framework more generally. Moreover, all SWF related funds should flow through the budget.

We strongly prefer a rules-based system over a discretionary one. Drawdown rules (from the SWF to budget) should be as rigid and well-specified as possible, while allowing some minimal flexibility to handle unforeseen events. These rules should be consistent with the objectives of the fund, the absorptive capacity of the economy and the government's social and economic development plans.

Should a SWF be an offshore or onshore entity?

We think there is a very strong case for the SWF to be an offshore entity, holding its financial resources in a foreign currency.

- **Avoidance of "Dutch Disease".** Historically, resource booms tend to be associated with large, export-driven balance of payments surpluses that result in a sharp appreciation of the local currency. While a resource boom is generally considered positive, currency appreciation has a negative effect of making the non-resource export sectors less competitive, causing those sectors to decline. This phenomenon is called the Dutch Disease. Indeed, PNG experienced Dutch Disease in the early 1990s. One way to mitigate this effect is to hold the bulk of the export proceeds.
- **Curb inflation pressures.** Resource booms also run the risk of creating domestic inflation as export proceeds increase liquidity in the financial system. This can lead to a lending boom, pressure on domestic resources and hence inflation. Again, by parking most of the export proceeds offshore, inflationary effects can be better managed.
- **Reduce the temptation to "raid the cookie jar."** Having the country's large, accumulated resource wealth held onshore and in local currency invites temptation, despite the best-intentioned structures for a rules-based withdrawal system. Keeping the SWF offshore provides an extra layer of protection.

How should the SWF's assets be invested?

Given the long duration of its liabilities combined with some short-term liquidity needs, the SWF will be similar to an insurance fund. Subject to the objectives of the fund, the investment strategy should clearly lay out the investible asset classes, risk tolerance, liquidity requirements, diversification objectives, etc. The SWF will be prohibited from investing in PNG government paper or undertaking any investment in or lending to the domestic economy.

The SWF's overall strategy should be reviewed periodically.

FEATURE NOTE

What about governance and transparency issues?

Governance and transparency issues, broadly defined, are critical for the fund to achieve its objectives. As a general point, Papua New Guinea's SWF should strive to conform as fully as possible to the Sovereign Wealth Fund Generally Accepted Principles and Practices (the Santiago Principles).

- The SWF should operate at arms length from the government at all times.
- The operations of the SWF should be overseen by a government-appointed, independent board. Board members could include the Treasury Secretary and central bank Governor. All board members should have the appropriate skill set.
- Transparency requires that timely, regular reports on the operations of the SWF should be disseminated to stakeholders and the general public.
- The SWF should be subject to international audits on a regular basis.
- Roles and responsibilities relating to the operation of the SWF should be clear and the relevant actors should be held fully accountable for their actions.

Can the SWF handle resource-based revenues other than those from the LNG project?

In principle, all revenues from exhaustible resources could be placed in the SWF. (And we would argue that one SWF for all resource flows is sufficient.) The logic is the same as for the LNG project proceeds, and all of the supporting arguments above would apply.

Paul Gruenwald
Bora Bedamu

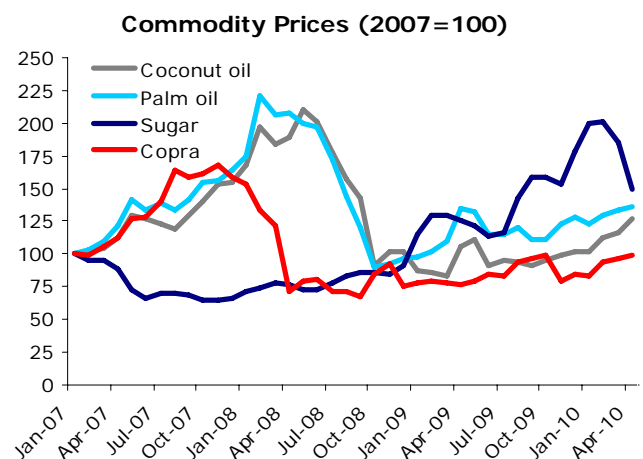
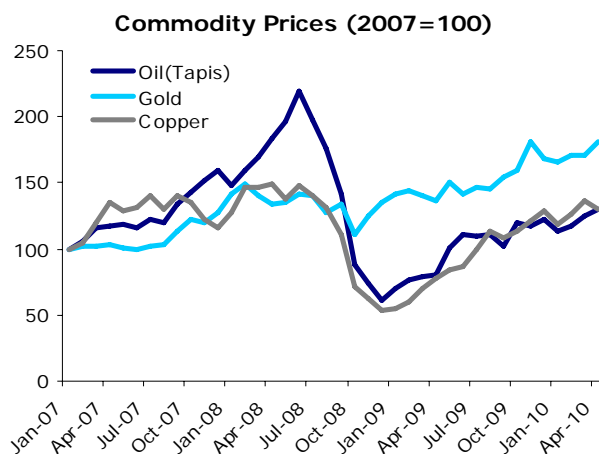
FINANCIAL MARKET UPDATE

EXCHANGE RATES

- Pacific currencies saw mixed results against the majors through mid-May of this year. SBD, WST and VUV appreciated against the USD while the FJD, PGK and TOP weakened. The FJD declined by 0.9% while in Papua New Guinea slow USD inflows and strong import demand saw the PGK depreciate by 3.2%. Most Pacific currencies have weakened against AUD this year to date.
- AUD and NZD have performed relatively well against the greenback this year. The European sovereign debt issue continues to have an impact on the foreign exchange markets of the Asia-Pacific region. Interest rate differentials and commodity prices continue to support the AUD. The Reserve Bank of Australia has hiked its cash rate by 75 basis points so far this year, to 4.50%.

COMMODITIES

- Commodity prices continue to strengthen as global economic conditions gradually improve, though all eyes are on Europe. China's robust growth coupled with some recent positive news in Europe should support commodity prices in the short-term.
- Crude oil traded from a recent high of US\$87/bbl on pressure due to recent negative inventory report in US and as the euro weakened against the greenback. US Government data suggest that domestic oil consumption remains weak. We still believe that low utilisation rates and high stockpiles will limit any gains above US\$100/bbl this year.
- Gold continues to out perform other commodities as investors hedge against inflation and concerns on Europe's sovereign debt uncertainty continue. Gold is trading comfortably above US\$1,000/oz. We predict gold prices will remain strong in the near-term.
- Apr's economic data from China point to an overheating economy. Metal prices (including copper) may decline as the government takes steps to cool economic activity and demand.



Sources: Bloomberg and ANZ Economics

FX AND POLICY INTEREST RATES

		CURRENT	JUN-10	SEP-10	DEC-10	MAR-11	JUN-11	SEP-11	DEC-11
FIJI	FJD-USD	0.519	0.515	0.510	0.493	0.483	0.479	0.474	0.470
	FJD-AUD	0.583	0.542	0.531	0.524	0.525	0.532	0.539	0.540
	Short term rates*	4.25	4.25	4.25	4.25	4.50	4.75	5.00	5.25
PAPUA NEW GUINEA	PGK-USD, eop	0.360	0.362	0.372	0.366	0.363	0.375	0.372	0.360
	PGK-AUD, eop	0.383	0.381	0.388	0.389	0.395	0.417	0.423	0.419
	Short term rates**	7.00	7.00	7.00	7.00	7.50	8.00	8.00	8.00
SAMOA	WST—USD, eop	0.399	0.400	0.403	0.406	0.409	0.417	0.421	0.423
	WST-AUD, eop	0.424	0.423	0.420	0.423	0.425	0.429	0.430	0.433
SOLOMON ISLANDS	USD-SBD, eop	8.060	8.060	8.060	8.070	8.075	8.076	8.076	8.076
	AUD-SBD, eop	7.460	7.657	7.738	7.586	7.429	7.268	7.107	7.026
TONGA	USD-TOP, eop	1.939	1.944	1.977	2.009	2.038	2.100	2.132	2.165
	AUD-TOP, eop	1.683	1.704	1.705	1.710	1.704	1.692	1.692	1.692
VANUATU	USD-VUV	102.2	100	102	102	105	108	112	115
	AUD-VUV	90.8	95.0	97.9	95.9	96.6	97.2	98.6	100.1
	Short term***	6.00	6.25	6.50	6.50	6.50	6.50	6.50	6.50

Note: The source of FX data is Bloomberg. As the currencies are illiquid with wide bid/offer spreads, the rate published is only indicative. (*) 91-day RBF notes, (**) Kina Facility Rate, (***) Discount rate

MACROECONOMIC FORECASTS

REAL GDP GROWTH (%)

	2009	2010	2011
Fiji	-2.5	1.8	2.5
PNG	4.5	6.5	8.0
Samoa	-4.3	1.5	5.7
Solomon Is.	0.6	3.4	4.1
Timor-Leste	7.7	7.8	8.0
Tonga	-0.4	0.6	1.7
Vanuatu	4.0	4.5	4.5

NOMINAL GDP (US\$ bn)

	2009	2010	2011
Fiji	3.7	3.9	4.2
PNG	8.2	10.4	10.8
Samoa	0.5	0.6	0.6
Solomon Is.	0.5	0.6	0.6
Timor-Leste	0.5	0.6	0.6
Tonga	0.3	0.3	0.3
Vanuatu	0.6	0.6	0.7

INFLATION (%)

	2009	2010	2011
Fiji	4.0	4.8	4.0
PNG	5.5	7.3	7.0
Samoa	6.1	3.5	4.7
Solomon Is.	1.5	3.0	5.0
Timor-Leste	0.1	6.0	5.0
Tonga	1.1	3.2	4.2
Vanuatu	4.6	4.0	3.5

FISCAL BALANCE (% OF GDP)

	2009	2010	2011
Fiji	-2.9	-3.5	-3.0
PNG	0.2	0.0	0.2
Samoa	-14.2	-8.4	-6.0
Solomon Is.	-0.5	-2.0	-2.8
Timor-Leste	-207.2	-156.8	-115.1
Tonga	-2.8	-2.5	-2.2
Vanuatu	0.1	2.0	2.3

CURRENT ACCOUNT BALANCE (% OF GDP)

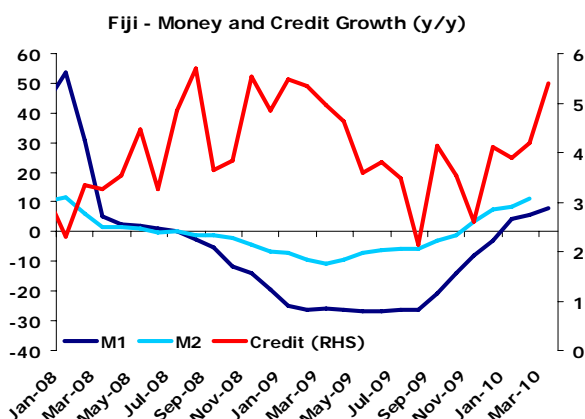
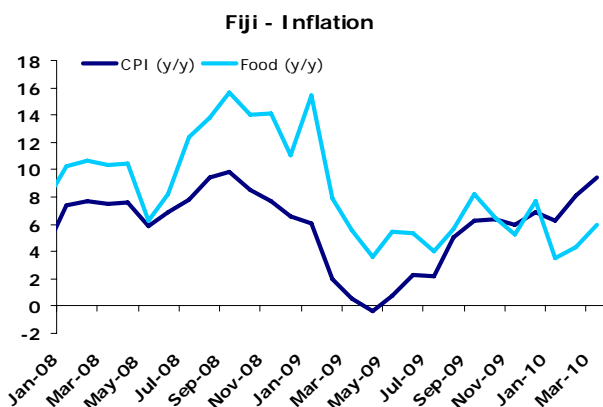
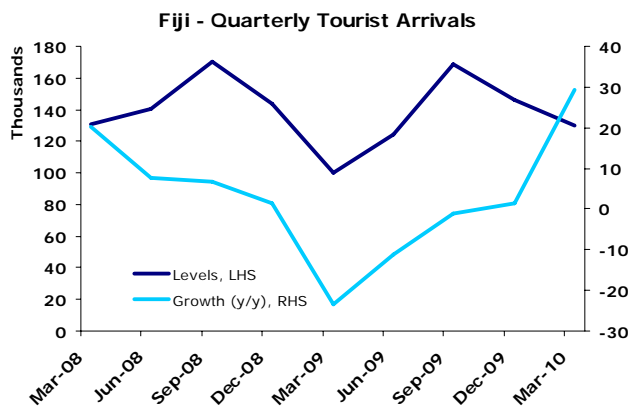
	2009	2010	2011
Fiji	-9.5	-15.0	-13.0
PNG	-6.0	-4.0	-1.0
Samoa	2.6	-3.6	-3.7
Solomon Is.	-7.0	-11.0	-12.0
Timor-Leste	367.4	483.2	433.9
Tonga	-15.7	-18.6	-20.0
Vanuatu	-4.0	-3.0	-4.0

FOREIGN EXCHANGE RESERVE (US\$ mn)

	2009	2010	2011
Fiji	600	575	550
PNG	2,457	2300	2015
Samoa	133.1	150.0	169.0
Solomon Is.	148.9	140	145
Timor-Leste	238	300	350
Tonga	84.1	71.4	68.3
Vanuatu	148.9	140	145

COUNTRY UPDATE

Country Update: Fiji



The pace of activity is picking up, albeit from a low base, but investment remains weak. Tourist arrivals this year have been robust, while trade flows have yet to recover. Inflation is pushing 10%, but appears to be moderating. Growth may be positive this year, although a full-fledged recovery requires greater political certainty and a resumption of investment.

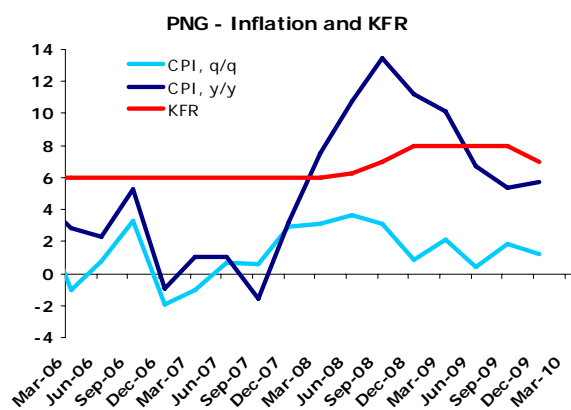
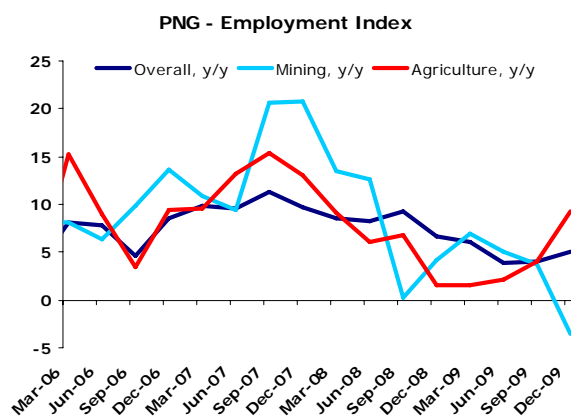
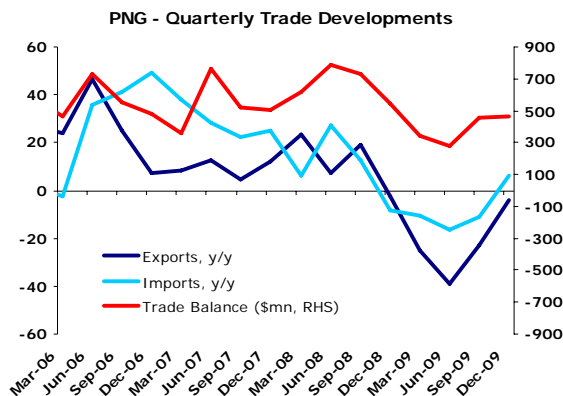
- Real activity is showing signs of picking up. Electricity production rose 6.2% (y/y) for the first three months of the year. Mining activity more than doubled during Jan-Feb compared with the same period in 2009; value-added tax collections were up 15.3%.
- Tourist arrivals continue to be robust, rising 26.5% (y/y) in Mar. This is in part due to an increase in the number of airlines serving Fiji this year. Inward remittances rose by 23.5% in the same period.
- 2009 export earnings fell 16.4% as re-exports fell by 31.3% and domestic exports by 9.0%. A significant fall in petroleum imports led the decline in re-exports. Imports fell 22.3% in 2009, led by intermediate goods (-40.0%) and investment goods (-17.6%). The 2009 trade deficit improved by 26% from 2008 levels.
- Inflation was at 9.4% (y/y) in Mar, up from 8.1% in Feb. Food inflation in Mar was 6.0%. Price pressures appear to be moderating as overall prices rose by just 0.2% in Mar. The government increased its end-2010 inflation target from 2.0% to 5.0%.
- The nominal effective exchange rate (NEER) rose 0.2% in Mar; however, on an annual basis, the NEER index was down by 18.9% as a result of the devaluation in April 2009. The real effective exchange rate fell 0.2% in Mar, indicating an improvement in competitiveness.
- The Reserve Bank of Fiji (RBF) increased the banks' minimum capital adequacy ratio from 8.0% to 12.0%, effective May 2010. The RBF also increased the statutory reserve deposit ratio from 7.0% to 8.5%, effective Jun. Both moves stem from concerns over the banking industry's operational risks.
- Fiji appears to be partially recovering as consumption and tourism/remittance flows have picked up. However, inflation is still on the rise, and credit remains weak. A greater level of political certainty would create stronger platforms for investment flows.

Paul Gruenwald

QUARTERLY ECONOMIC DATA	MAR 08	JUN 08	SEP 08	DEC 08	MAR 09	JUN 09	SEP 09	DEC 09
Consumer Price Index, % y/y	7.5	6.9	9.8	6.6	0.5	2.3	6.3	6.8
Domestic Credit, % y/y	5.3	3.3	3.6	4.8	4.9	3.8	4.2	4.1
Exports, % y/y	26.8	20.2	21.3	19.6	-13	-24.6	-15.5	-16.4
Imports, % y/y	8.6	38.2	40.9	16.1	-0.2	-24.4	-31.1	-22.3
Trade Balance, US\$ mn	-83	-129	-133	-84	-56	-89	-55	-117.5
Foreign Exchange Reserves, US\$ mn	504	481	429	317	241	318	523	562

Sources: Reserve Bank of Fiji, ADB, IMF

Country Update: Papua New Guinea



Despite last year's decline in trade brought on by global conditions, there was employment growth at the end of the year. As commodity prices increase on the back of the global recovery, trade is expected to improve. Employment will experience a boost as the LNG project enters its construction phase.

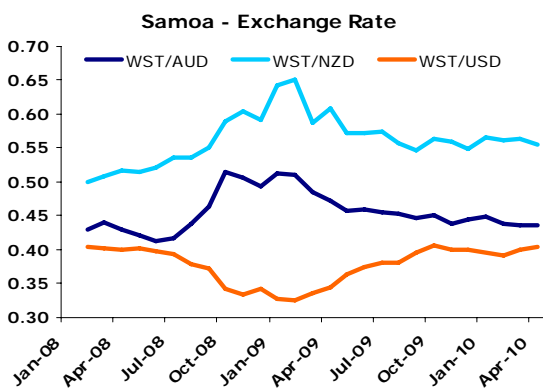
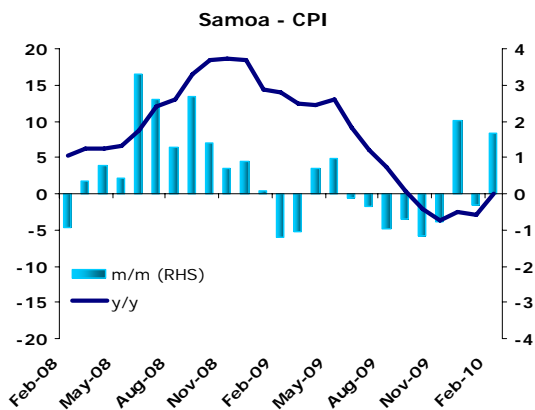
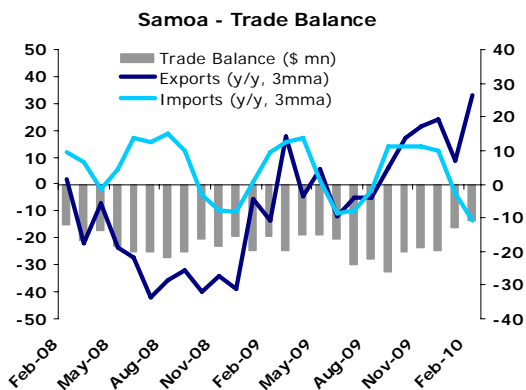
- Trade continued to improve in H2 2009 after a slowdown in H1. Exports in Q4 2009 improved, falling 4.0% (y/y) compared to a 22.9% fall in Q3. Over the same period, imports improved to 6.0% (y/y) from a negative 11.1% (y/y) driven significantly by imported transport equipment.
- The balance of payments had a surplus of K390mn in Q4, down from the previous quarter's K675mn surplus. The fall was due to a large decline in the financial account.
- Employment, excluding the mineral sector, increased by 0.8% (q/q) in Q4 2009 from 0.6% (q/q) in Q3. Employment growth was broad-based, with a significant contribution from building and construction. Mineral sector employment growth remained firm at 0.2% (q/q) over the same period.
- Inflation eased to 4.8% (q/q, saar) in Dec 09, compared to 7.5% (q/q, saar) in the previous quarter. Headline inflation was 5.7% (y/y). Pressure appears to be receding but strong domestic demand and wage increases pose an upside risk to inflation.
- The central bank held its kina facility rate (KFR) at 7.00% in May 2010. The bank's next move will be determined by Q1 inflation figures and outlook. We expect the KFR to remain flat in 2010.
- The government's ability to address issues of community and corporate security and the perception of the diminishing rule of law may affect investor confidence in the LNG project. As a response, the government is considering an offshore sovereign wealth fund to manage windfall revenues.
- The economic outlook should continue to improve along with global trade and commodity prices. We expect GDP to grow by about 6.5% in 2010 from 4.5% in 2009. Inflation is expected to ease in H1 but pressure should build and inflation could rise to 7.0% by the end of the year.

Bora Bedamu

QUARTERLY ECONOMIC DATA	MAR 08	JUNE 08	SEP 08	DEC 09	MAR 09	JUN 09	SEP 09	DEC 09
Employment Index, % y/y	8.5	8.3	9.3	6.7	6.1	3.9	4.0	5.0
Consumer Price Index, % y/y	7.5	10.7	13.5	11.2	10.1	6.7	5.3	5.7
Exports, % y/y	23.2	7.0	19.3	-2.6	-25.2	-38.9	-22.9	-4.0
Imports, % y/y	6.0	27.3	12.6	-8.3	-10.3	-16.4	-11.1	6.0
Trade Balance, US\$ mn	614	790	734	542	344	275	456	460
Foreign Exchange Reserves, US\$ mn	2,039	2,418	2,454	2,093	1,950	2,283	2,321	2,604

Sources: Bank of Papua New Guinea, ANZ Economics

Country Update: Samoa



GDP growth turned positive at the end of 2009 and trade momentum picked up in Q1 2010. Feb's headline inflation remained negative for the fifth consecutive month. A slow recovery looks likely as tourism and private remittances have yet to pick up.

- The economy recorded 0.7% (y/y) growth in Q4 2009, after five consecutive quarters of contraction. Annual GDP in 2009 declined by 1.8%, led by the construction and manufacturing sectors.
- Feb's exports rose 54.6% (y/y) after contracting 35.2% in Jan. The rise is due to increased coconut cream exports to New Zealand. Meanwhile, imports jumped 138.2% in Feb from 0.4% in Jan, due to a one-off, aid-funded ferry purchase from Japan. Feb's trade deficit widened to WST80.9mn.
- Tourist arrivals fell 13.3% (y/y) in Feb from a 6.5% rise in Jan. Earnings from tourism fell 19.8% in Feb after a 2.2% fall in Jan. Private remittances, which account for just over 20% of GDP, fell 3.5% in Feb following an 11.9% fall in Jan.
- The CPI fell 0.1% (y/y) in Feb compared with a 2.9% fall in Jan, mainly due to lower imported inflation. On a m/m basis, the CPI rose 1.7%. Food prices, which represent 50.3% of the CPI, experienced a 2.6% rise. Core inflation rose from -2.7% in Jan to -0.8% in Feb.
- Going forward, the government has approved a stimulus package for coconut, cocoa and coffee production, and the Asian Development Bank has launched a loan assistance programme to increase tourism numbers.
- We expect continued improvement in trade volumes as the global economy recovers. A strong rebound in tourism and private remittances is unlikely in the near-term. GDP growth in 2010 will be around 3%.

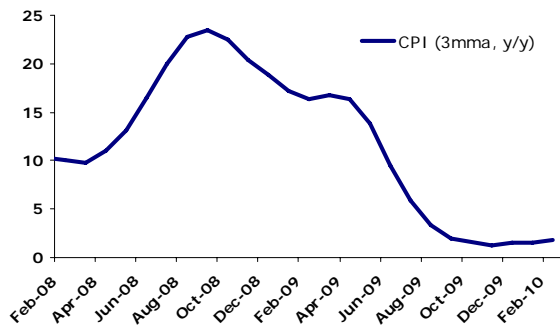
Isaac Thong

QUARTERLY ECONOMIC DATA	MAR-08	JUN-08	SEP-08	DEC-08	MAR-09	JUN-09	SEP-09	DEC-09
Consumer Price Index, % y/y	6.3	7.2	13.9	18.4	13.0	9.2	0.3	-2.5
M2, % y/y	1.9	12.1	6.9	5.8	18.2	7.7	6.9	9.1
Exports, % y/y	-29.4	-41.0	-29.9	-45.2	47.8	-5.6	26.6	33.8
Imports, % y/y	15.0	-22.3	25.4	22.0	-32.5	-6.2	-37.5	22.7
Trade Balance, US\$ mn	-19.8	-16.1	-26.1	-19.8	-12.9	-15.1	-15.6	-24.2
Foreign Exchange Reserves, US\$ mn	100.6	101.5	90.2	81.3	84.8	100.4	124.5	144.5

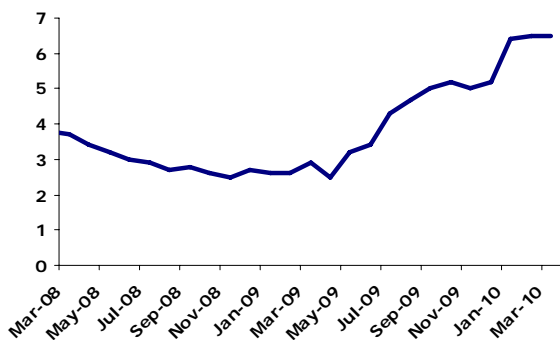
Sources: Central Bank of Samoa, Samoa Ministry of Finance

Country Update: Solomon Islands

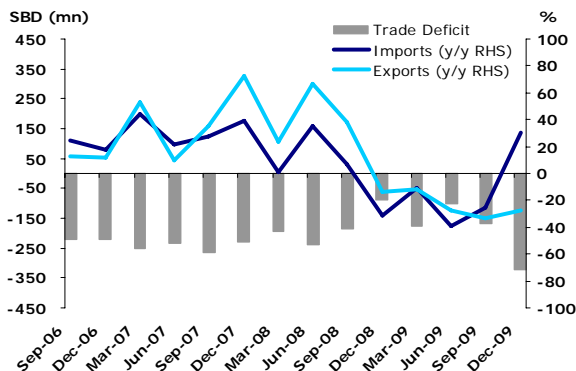
Solomon Islands - Consumer Price Index



Solomon Islands - Import Cover (mths)



Solomon Islands - Trade Developments



The economy continues to recover with increased production and exports. Foreign reserves continue to rise, while the trade deficit widens. Inflation is rising but remains benign.

- Exports rose sharply by 34.2% (m/m) in Mar due to an increase in shipments of log products. Exports of alluvial gold increased; however, fish, cocoa and copra exports declined.
- The balance of payments (BOP) surplus fell sharply from SBD24.7mn (revised) in Feb 2010 to SBD0.1mn in Mar. Total imports, which rose 28.0% (m/m) to SBD176.3 mn, and other payments led the decline.
- Inflation for Feb rose to 1.8% (y/y) from 1.5% in Jan. Prices for local and imported components rose to 2.2% and 1.5%, respectively.
- Total transfer receipts surged 79.9% (m/m) to SBD75.4mn in Mar, due to increased activities from NGOs and the Regional Assistance Mission to Solomon Islands (RAMSI) and RAMSI-related affiliates.
- M3 contracted by 0.6% (m/m) Apr to SBD1.8bn. Year-on-year growth remained strong at 26.9%.
- Total domestic credit rose by 5.9% (m/m) to SBD1245mn in Apr. The decline in private sector credit was offset by increased government net credit.
- Official foreign reserves rose by 6.9% (m/m) to SBD1342mn in Apr. On a year-by-year basis, reserves grew 95.9%. Import cover was around 6½ months.
- The SBD remained stable against the USD; depreciated against the AUD, GBP and NZD; and, appreciated against the yen and euro.
- The central bank intends to maintain an accommodative policy stance, but will continue to monitor economic growth and price stability, and consider changes as required.
- The World Bank has predicted a growth rate of around 3.5% in 2010 based on a rebound in commodity prices and overall growth in the Pacific region.

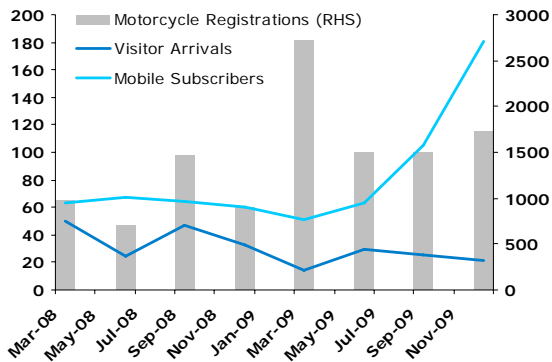
Eesh Mengi

QUARTERLY ECONOMIC DATA	MAR-08	JUN-08	SEP-08	DEC-08	MAR-09	JUN-09	SEP-09	DEC-09
Domestic Credit, % y/y	60.1	74.4	56.6	47.8	17.1	11.9	0.60	-5.3
Consumer Price Index, % y/y	6.3	5.8	10.0	17.5	16.5	9.6	2.0	1.5
Exports, % y/y	24.0	66.9	38.4	-14.0	-11.3	-27.5	-33.3	-27.8
Imports, % y/y	1.4	34.9	7.3	-31.0	-10.6	-38.8	-25.9	30.3
Trade Balance, SBD mn	-27.2	-23.1	-26.5	-87.5	-176.5	-100.7	-169.8	320.1
Foreign Exchange Reserves, US\$ mn	117.9	124.1	127.8	117.9	100.8	98.2	93.3	144.0

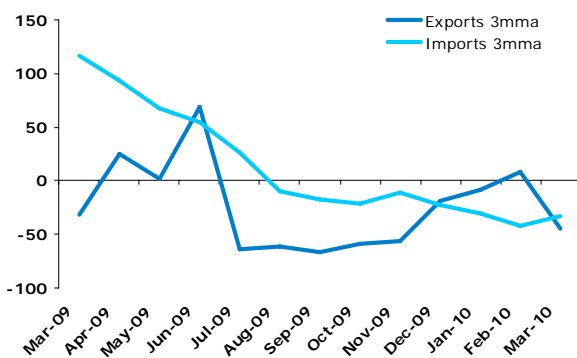
Sources: National Directorate of Statistics, Economist Intelligence Unit

Country Update: Timor-Leste

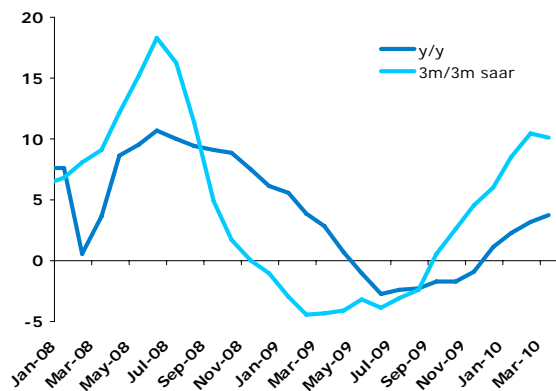
Timor-Leste - Activity Indicators (y/y)



Timor-Leste - Trade Developments (y/y)



Timor-Leste - Inflation



Domestic demand continues to rise helped by government spending. However, with the weakening USD the nominal effective exchange rate has depreciated by 17% in the last 12 months, and inflation pressures have emerged. In the absence of currency adjustments, and fanned by strong demand, inflation is likely to remain high.

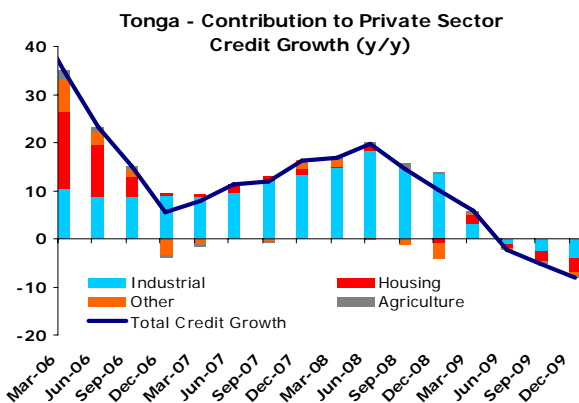
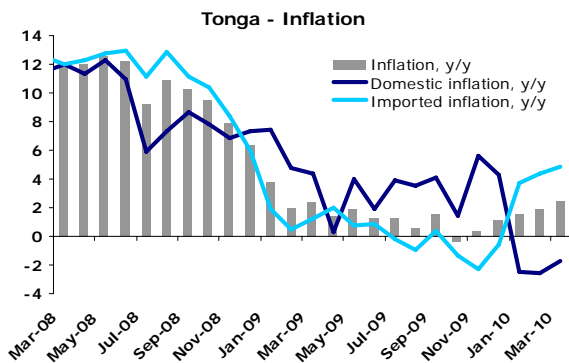
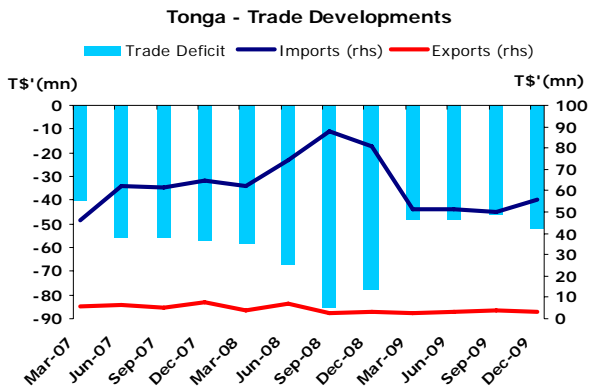
- Domestic activity indicators indicate a strengthening economy. Mobile subscriptions jumped by 180.7% (y/y) in Q4, from 105.5% in Q3. Motorcycle registrations surged by 84.3% (ytd y/y) in Q4 while electricity consumption rose by a solid 44.5% (y/y). However, growth in visitor arrivals fell to 21.0% (y/y) in Q4, down from 25.6% in the previous quarter.
- Exports declined by 44.6% (y/y) in Q1 2010 from an 18.2% decline in Q4 2009, due in part to coffee exports, and re-exports. Re-exports, which account for nearly 90% of total exports, fell 39.3% (y/y) in Q1 2010, from a 22.7% decline in Q4 2009. Imports also contracted by 32.6% (y/y) in Q1 2010 against a 22.2% decline in the previous quarter.
- Inflation rose to 3.7% (y/y) in Mar, up from 1.1% in Dec 2009. However, on a momentum basis, inflation reached 10.1% (3m/3m saar) in Mar. This was mainly due to rising construction costs which contributed to a 6.0% (q/q) increase in the Q1 housing price index. However, with housing excluded, the CPI still rose 1.5% (q/q) in Q1 led by rising food prices.
- Credit growth fell to 2.7% (y/y) in Q1 from 5.5% in Q4 2009. Tourism and services sector credit fell by 53.2% (y/y) in Q1, down from the 3.8% growth in Q4 2009. This may be due to the completion of a number of hotel projects. However, construction sector credit rose 57.3% (y/y) in Q1 from 29.2% in Q4. Personal credit also improved marginally, declining just 6.0% (y/y) in Q1 as compared with the 12.5% decline in Q4.
- Broad money growth slowed to 53.2% (q/q saar) in Q1 from 82.8% in the previous quarter, but is still an improvement on 2009's 23.1% (y/y) result.
- We expect growth to remain buoyant in the medium term with continued government spending and a gradually improving external environment. However, private investment will need to increasingly take the lead in driving growth.

Chang Wei Liang

QUARTERLY ECONOMIC DATA	JUN-08	SEP-08	DEC-08	MAR-09	JUN-09	SEP-09	DEC-09	MAR-10
Mobile Subscribers, % y/y	67.2	61.2	59.8	50.9	63.3	105.5	180.7	n/a
Visitor Arrivals, % y/y	24.1	46.8	32.7	14.6	29.1	25.6	21.0	n/a
Consumer Price Index, % y/y	10.7	9.1	6.1	2.8	-2.7	-1.7	1.1	3.7
Exports, US\$ mn	7.1	19.2	11.3	7.0	12.0	6.3	9.2	3.9
Imports, US\$ mn	49.5	68.2	85.7	93.2	77.2	58.3	66.4	62.8
Trade Balance, US\$ mn	-42.5	-49	-74.4	-86.2	-65.2	-52	-57.2	-59

Sources: National Directorate of Statistics, Economist Intelligence Unit

Country Update: Tonga



Growth is likely to remain low in the near term as remittances and tourism receipts continue to be affected by global economic conditions. Risks are tilted to the downside, due to rising oil prices and low employment.

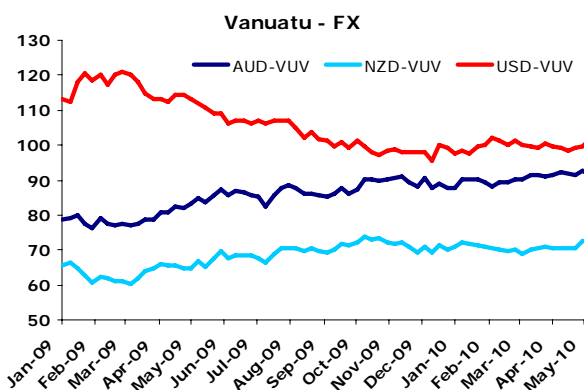
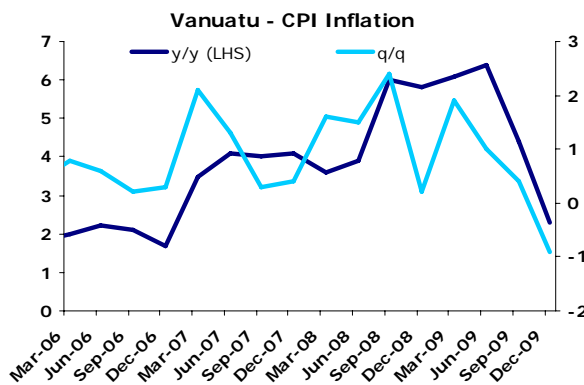
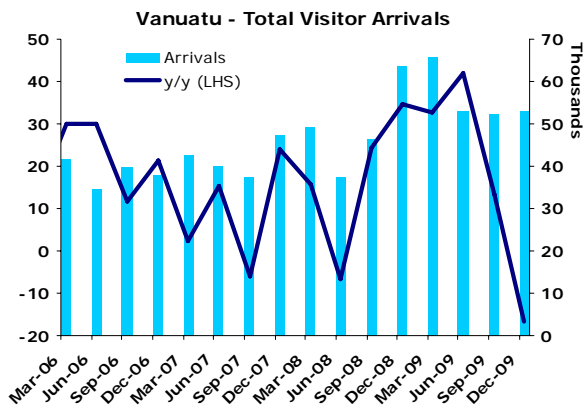
- GDP contracted by 0.4% in 2009, according to the Asian Development Bank.
- Tourist receipts deteriorated for the fourth straight month due to soft external demand, dropping 7.9% (y/y) in Feb from a 5.3% decline in Jan.
- Private remittances declined by 0.6% (m/m) in Feb to TOP154.6mn in Jan. On an annual basis, private remittance growth remained negative, falling 14.4%.
- External trade remained weak. Imports fell 31.5% (y/y) in Feb compared with a 33.1% decline in Jan. Exports declined at a more moderate pace of 12.9% in Feb, compared with a 13.9% decline in the previous month.
- Inflation rose from 1.9% (y/y) in Feb to 2.5% in Mar. Rising inflation was largely attributed to imported inflation, which increased by 4.9%. This was partially offset by a 1.7% fall in domestic prices. Inflationary pressures are likely to grow with expected rises in food and fuel prices.
- Official foreign reserves rose 2.0% (m/m) to TOP155.5mn in Mar, its fastest rise in five months. On an annual basis, foreign reserves climbed 24.9% compared with 22.4% in Feb. The current level of reserves covers 6.5 months of imports, significantly higher than 2008's 4.9 month coverage.
- Private sector credit growth continued to decline, falling 12.9% (y/y) in Feb from an 11.3% fall in Jan. Both household and business lending contributed to the decline, falling 4.6% and 19.3% respectively.
- Tonga's 2010 growth will be modest, at around half a percent, given its reliance on imports and remittances. Tourist receipts and remittances will improve gradually as the global economy recovers. Inflation will increase with the recovery in domestic demand and from external fuel and oil price pressures.

Pay Shu Zhen

QUARTERLY ECONOMIC DATA	MAR 08	JUN 08	SEP 08	DEC 08	MAR 09	JUN 09	SEP 09	DEC 09
Consumer Price Index, % y/y	12.0	12.2	10.3	6.4	2.4	1.2	1.6	1.1
Private Sector Credit, % y/y	16.8	19.7	14.5	10.1	5.8	-2.3	-5.3	-8.2
Exports, % y/y	1.1	27.2	28.4	-7.1	13.6	-61.3	-6.4	-6.4
Imports, % y/y	6.1	36.0	22.0	0.8	-2.8	-15.7	-46.7	-46.7
Trade Balance, US\$ mn	-31.7	-36.4	-43.1	-36.4	-22.3	-24.0	-23.9	-27.4
Foreign Exchange Reserves, US\$ mn	52.4	48.2	64.8	58.0	60.3	67.7	85.0	84.1

Sources: National Reserve Bank of Tonga, Tonga Department of Statistics

Country Update: Vanuatu



The economy has weathered the global downturn well, largely due to a robust tourism sector serving regional markets. However, tourism growth may ease as regional holiday-makers opt for long-haul destinations. The Reserve Bank of Vanuatu may start to normalise monetary policy mid-year.

- The tourism sector appeared to be softening at the start of 2010. Visitor arrivals fell by 41.0% (y/y) in Feb, but its impact on growth was mitigated by a rise in the average length of stay, from 8.2 to 11.7 days.
- CPI inflation slowed to 2.3% (y/y) in Q4 2009, down from 3.4% in Q3. Consumer price momentum slowed due to lower food prices, easing to -0.9% (q/q) compared with a 0.4% rise in Q3. Going forward, the RBV has estimated that a new excise tax on beverages and tobacco will add around 0.6ppt to inflation in Q1. Rising global commodity prices in H2 2009 are also expected to feed into domestic prices in Q2. Therefore, the CPI should rise toward the upper end of the RBV's 2010 target band of 4.0%.
- The VUV weakened in Q2 on a pullback in global risk appetite, down 2.5% and 2.3% against the USD and NZD respectively. The VUV strengthened slightly against the AUD, as the decline in AUD/USD outpaced at 3.3%.
- Foreign reserves rose to VUV14.5bn in Feb, up from 13.9bn at end-2009. The RBV expects reserves to trend downwards in 2010, but remain comfortably above the official target of four months of import cover.
- The RBV kept the rediscount rate unchanged at 6.00% in Mar but signalled its intent to normalise monetary policy in mid-2010; the reserve ratio, which was cut in late-2008, should return to "conventional levels". We expect the RBV to raise interest rates by 50bps this year, with the first 25bps hike likely to occur mid-year.
- We expect GDP growth to gain pace to 4.5% in 2010, up from around 4.0% in 2009. Domestic demand should improve on the back of a recovery in the farming sector and strong construction activity is likely to remain robust supported by donor projects.

Yeo Han Sia

QUARTERLY ECONOMIC DATA	MAR-08	JUN-08	SEP-08	DEC-08	MAR-09	JUN-09	SEP-09	DEC-09
Consumer Price Index, % y/y	3.6	3.9	6.0	5.8	6.1	5.5	4.4	2.3
Tourist (thou)	49.4	37.3	46.3	63.6	65.6	52.9	53.9	53.0
Exports, % y/y	66.8	26.0	54.7	36.5	259.8	26.9	-29.8	28.3
Imports, % y/y	49.3	36.2	36.7	23.5	-14.8	-16.3	-14.7	4.9
Trade Balance, US\$ mn	-63.5	-67.8	-59.4	-61.8	-31.0	-48.0	-55.0	-72.6
Foreign Exchange Reserves, US\$ mn	121.8	123.1	117.7	114.1	106.9	121.4	157.0	148.9

Sources: Reserve Bank of Vanuatu, ANZ Economics

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