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Highlights

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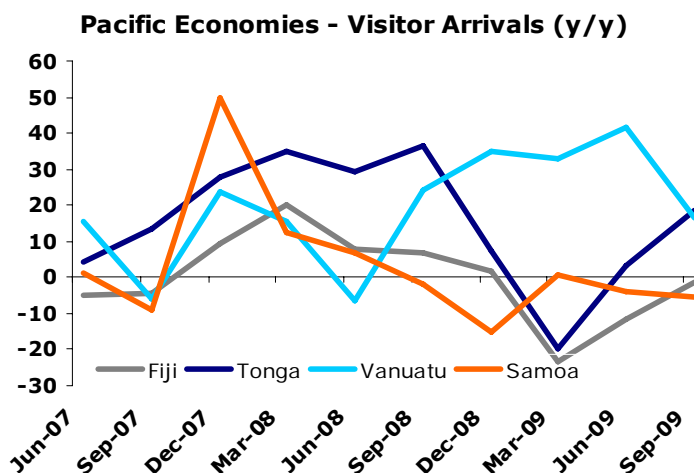
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- The Pacific region has begun to recover, particularly in those economies with resource-based exports. We have also begun to see some improvement in the tourism-based economies reflecting out-performance in Australia.
- Inflation pressures have picked up in the recent reporting period, but generally remain under control. A notable exception is Fiji.
- Our Feature Note looks at the drivers of Pacific GDP. Surprisingly, we found no unifying factors across the region, although tourism and exposure to China clearly boost growth.
- Increased risk aversion has weighed on Pacific currencies in USD terms. However, the region has generally out-performed AUD, which has come under added pressure from tightening by China.

Chart Pick: Tourism Flows Show Signs of a Recovery



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What Drives Growth in the Pacific?

In this Feature Note we investigate the key factors driving GDP growth in the Pacific. We found the answer to be complex. First, the correlation of GDP growth amongst the six countries in our sample was surprisingly low, and in many cases was negative! Second, growth correlations with likely external candidates are highly uneven. Some countries have a high growth correlation with China, some countries have a high growth correlation with (tourism from) Australia and New Zealand, while in others growth appears to be driven by forces specific to the domestic economy. All told, there is much less homogeneity than we thought. We therefore caution against generalising about growth drivers in Pacific.

What drives GDP growth in the Pacific? As commentators on economic developments in the region, we endeavoured to gain a deeper understanding of the key factors driving GDP growth. A number of stylised facts informed our “priors.” Since countries (or at least groups of countries) in the Pacific are broadly similar in structure, we expected growth to be reasonably highly correlated across countries. Moreover, since all countries in the region are highly open, we were expecting some clear and consistent (across countries, or at least groups of countries) external drivers on both the trade and tourism fronts. To undertake our analysis we used per capita GDP growth rates¹ for the six countries in our sample (Fiji, Papua New Guinea, Samoa, the Solomon Islands, Tonga and Vanuatu) over the period 1990 to 2007.²

Growth Correlations Were Weaker than Expected

Correlations of GDP growth amongst Pacific countries are surprisingly low. Figure 1 presents the GDP growth cross-correlations for our sample period. Several results are striking. First, the table does not contain a single correlation greater than one-half in absolute value. That is, in no pair of countries in our sample does GDP growth move together on average by a factor of 0.5. Second, more than one-half of the growth correlations are negative. The implication is that not only do growth rates not move very strongly together (our first point above), but that more often than not they move in opposite directions! This suggests that finding unifying growth themes for the region was going to be unlikely.

Figure 1: GDP Growth Cross-Correlation Matrix

	Papua New Guinea	Samoa	Solomon Islands	Tonga	Vanuatu	Fiji
Papua New Guinea	--	-0.14	0.45	0.20	-0.04	-0.07
Samoa	-0.14	--	-0.34	-0.03	-0.47	-0.17
Solomon Islands	0.45	-0.34	--	-0.13	0.36	0.11
Tonga	0.20	-0.03	-0.13	--	-0.30	0.00
Vanuatu	-0.04	-0.47	0.36	-0.30	--	-0.18
Fiji	-0.07	-0.17	0.11	0.00	-0.18	--

We obtained somewhat higher correlations with Australasia and China. Given the low growth correlations within the Pacific, we looked at whether a stronger relationship might exist with countries that have strong trade and other economic linkages to the region. The obvious candidates were Australia, New Zealand

¹ On a technical note, using GDP growth rates rather than GDP levels ensures that the underlying data series are “stationary,” which allows us to run standard ordinary least squares (OLS) regressions below. Using per capital growth neutralises the effects of differing rates of population growth across countries.

² As always with our work on the Pacific, country choice was dictated by data availability.

and China. Figure 2 shows that we were able to obtain higher (and more positive) correlations on average. In particular, growth in Papua New Guinea, and to a lesser extent the Solomon Islands, appears to be relatively highly correlated with growth in China. This is not too surprising given the resource trade between those economies. Correlations with Australia and New Zealand were lower than expected, with only Samoa posting a relatively high number. (Below we substitute tourist departures for GDP in Australia and New Zealand and get better results.)

Figure 2: Growth Correlations with Candidate Asian Economies

	NZ	AU	CN
Papua New Guinea	0.06	-0.21	0.69
Samoa	0.52	0.41	0.10
Solomon Islands	-0.16	0.00	0.41
Tonga	0.12	-0.16	0.21
Vanuatu	-0.33	-0.07	0.02
Fiji	0.13	0.18	-0.32

Some Simple Regression Results

Given the weak correlations derived above, we adopted an eclectic approach to modelling Pacific GDP growth rates. Specifically, our menu of successful—in a statistical sense—explanatory variables comprised the following. (A full list of candidate variables as well as the details of our empirical work appears in the Appendix).

- **Initial conditions (relative GDP).** This variable seeks to capture the effects of convergence—namely, that lower income countries tend to grow faster than (and converge with) more advanced economies. We used the ratio of US GDP to each Pacific country's GDP in the first year of our sample; the average value of this ratio was about 12. We expected the sign to be positive.
- **Inflation.** High inflation distorts relative prices, increases uncertainty and therefore lowers growth. We expected the sign of this variable to be negative.
- **Australia and New Zealand tourist departures.** To focus directly on the most likely channel from activity in Australia and New Zealand, we used tourist departure growth, with an expected positive sign. Furthermore, after running a version of the model with this variable affecting all Pacific countries equally—which gave poor results—we “turned on” this variable (used a dummy) only for Vanuatu and the Solomon Islands, where the effect of Australasian tourist departures was statistically significant.
- **China.** We used China's GDP growth as an explanatory variable with an expected positive sign—since higher growth likely requires more commodity imports. This was applied across the Pacific evenly in Model 1 (where Chinese growth turned out to be statistically significant) and with dummies for the statistically significant countries only—Papua New Guinea and the Solomon Island in Model 2.
- **Event dummies.** To improve model fit, we incorporated event dummies for the Asian financial crisis as well as a handful of country-specific major economic and political events that had an impact on growth

Model 1 shows that Pacific growth is best explained by country-specific tourism links to Australia and New Zealand and general exposure to China. The summary results appear in Figure 3. Model 1 explains 57% of the variation in Pacific growth in our panel of countries. For the specific cases of Vanuatu and the Solomon Islands, a 1% increase in tourist departures from Australia and New Zealand raises per capita growth by about ¼%. Across the entire Pacific, a 1% increase in China's GDP growth rate has roughly the same effect *on average*. Also of note, the initial conditions term, which has an average value of about 12, raises per capita GDP growth by just over 0.1% on average (12 x .009).

Figure 3: Summary Regression Results

Model 1: Explanatory variables		Model 2: Explanatory variables	
CPI	-0.0015	CPI	-0.0013
Relative GDP	0.0089	Relative GDP	0.0094
China	0.2327	China-PNG	0.7450
Tourist-VAN	0.2599	China-SOL	0.6160
Tourism-SOL	0.2404	Tourist-VAN	0.2749
		Tourism-SOL	0.2344
Model fit		Model fit	
R-squared	0.57	R-squared	0.60

Model 2 shows that country-specific exposure to China dominates growth. In this version of the model, we turn on the China variable only for those economies—Papua New Guinea and the Solomon’s—where the linkage is statistically significant. This raises the effect of a 1% increase in China’s GDP growth from about ¼% in Model 1 to ¾% in PNG and 0.6% in the Solomon Islands. The effect of Australian and New Zealand tourism on Vanuatu and the Solomon Island remains at around ¼% for each 1% increase in departures. The contribution of the initial conditions variable was broadly unchanged. Overall, Model 2 does a slightly better job of explaining the data than Model 1 given its higher R-squared of 0.60.

Conclusion

We found no single, unifying theme for Pacific growth. Our modelling suggests that domestic factors are the main growth drivers for Fiji, Samoa and Tonga. The positive elasticity of the growth rate with respect to relative income (our proxy for initial conditions) implies that convergence is a dominant factor in these economies. The impact of external factors was uneven across the region. Papua New Guinea and the Solomon Islands were the main beneficiaries of strong Chinese growth. Outbound tourism from Australia and New Zealand had the largest effect on the Solomon Islands and Vanuatu. Overall, our main takeaway is that one should be careful not to generalise when assessing growth drivers in the region.

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Appendix

This section provides a fuller explanation of our model. Panel estimation allows us to include N countries and T time periods in our data. The basic assumption is that individual country relationships with growth determinants have the same parameters. Pooling the data thus increases the total sample size to N times T, which is useful with short time series. To allow for systematic differences across countries, we use a fixed-effects model.

Given the multiplicity of possible growth determinants, we first identify a number of variables that are potentially correlated with economic growth in the Pacific countries. Next, a general-to-specific approach was used to arrive at the final empirical model.

Figure A1: List of Candidate Variables

Global agriculture prices	Consumption/GDP	Inflation
Global commodity prices	Investment/GDP	Tourist arrivals
Current account/GDP	Government/GDP	GDP and consumption growth in major economies
Trade openness	Inward investment/GDP	Relative income (to US)

All data series were transformed to year-on-year growth terms except for data expressed as GDP shares and relative income levels. The dependent variable is per capita GDP growth, consistent with the empirical literature. In addition to the fixed-effects, multiplicative dummy variables were also used to control for the effects of 1/ Asian financial crisis, 2/ China's economic growth, 3/ outbound tourism from Australia and New Zealand, 4/ one-off country-specific factors that affected growth in various Pacific countries.

List of dummy variables

DUMAFc	= Asian financial crisis (1997)
DUM90	= Fiji's economy rebounded after the 1987 coups (1990)
DUM93	= PNG's Kubutu oilfield starts production (1993)
DUM00	= Ethnic turbulence in Solomon Islands (2000)
DUM02	= Decline in air travel due to SARS and 9/11 terrorist attacks (2002)
Dxxx	= Multiplicative dummies for respective Pacific countries

List of explanatory variables

CPI	= Annual CPI inflation rates
RELGDP	= Ratio of per capita GDP in the US relative to the domestic economy
AUNZTOUR	= Annual rise in outbound tourism in Australia and New Zealand
CN	= Annual GDP growth in China

Full Results of Model 1

Dependent Variable: GDPPW_
 Method: Panel Least Squares
 Sample: 1989 2007
 Periods included: 19
 Cross-sections included: 6
 Total panel (balanced) observations: 114

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.112368	0.035629	-3.153877	0.0021
CPI_	-0.001513	0.000950	-1.591869	0.1146
RELGDP_	0.008890	0.002842	3.127857	0.0023
DUMAFc	-0.036378	0.014476	-2.512962	0.0136
CN	0.232742	0.121341	1.918091	0.0580
DSOL*AUNZTOUR	0.259945	0.125886	2.064914	0.0416
DVAN*AUNZTOUR	0.240430	0.130384	1.844020	0.0682
DVAN*DUM02	-0.073467	0.037049	-1.982969	0.0502
DPNG*DUM93	0.205565	0.035558	5.781137	0.0000
DSOL*DUM00	-0.172502	0.035387	-4.874710	0.0000
DFIJ*DUM90	0.170636	0.036101	4.726646	0.0000

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.569416	Mean dependent var	0.008630
Adjusted R-squared	0.503510	S.D. dependent var	0.048432
S.E. of regression	0.034126	Akaike info criterion	-3.788040
Sum squared resid	0.114130	Schwarz criterion	-3.404013
Log likelihood	231.9183	Hannan-Quinn criter.	-3.632185
F-statistic	8.639852	Durbin-Watson stat	2.026967
Prob(F-statistic)	0.000000		

Full Results of Model 2

Dependent Variable: GDPPW_
 Method: Panel Least Squares
 Sample (adjusted): 1989 2007
 Periods included: 19
 Cross-sections included: 6
 Total panel (balanced) observations: 114

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.118018	0.033553	-3.517355	0.0007
CPI_	-0.001334	0.000924	-1.443134	0.1522
RELGDP_	0.009353	0.002764	3.383691	0.0010
DUMAFc	-0.036593	0.014027	-2.608787	0.0105
DPNG*CN	0.744977	0.299769	2.485173	0.0147
DSOL*CN	0.616017	0.277193	2.222337	0.0286
DSOL*AUNZTOUR	0.274935	0.122399	2.246217	0.0270
DVAN*AUNZTOUR	0.234444	0.126366	1.855276	0.0666
DVAN*DUM02	-0.074039	0.035926	-2.060867	0.0420
DPNG*DUM93	0.182930	0.036571	5.002031	0.0000
DSOL*DUM00	-0.166390	0.034492	-4.823987	0.0000
DFIJ*DUM90	0.154713	0.034383	4.499735	0.0000

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.598871	Mean dependent var	0.008630
Adjusted R-squared	0.532706	S.D. dependent var	0.048432
S.E. of regression	0.033107	Akaike info criterion	-3.841357
Sum squared resid	0.106322	Schwarz criterion	-3.433328
Log likelihood	235.9574	Hannan-Quinn criter.	-3.675761
F-statistic	9.051106	Durbin-Watson stat	2.130906
Prob(F-statistic)	0.000000		

Financial Markets Update

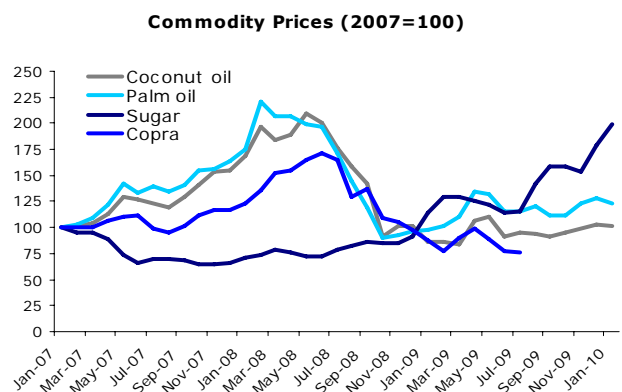
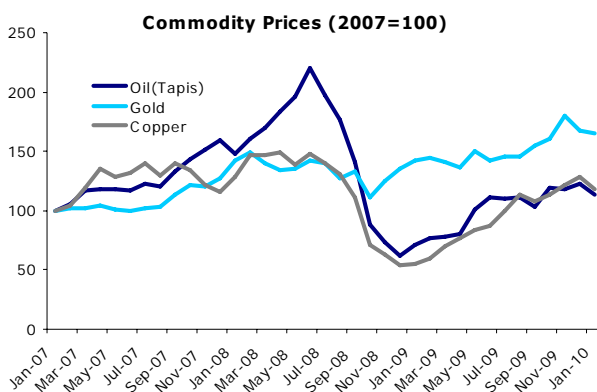
Exchange Rates

- Increased risk aversion due to sovereign debt fears in Europe and the potential knock-on effects for global growth has pushed the USD to nine month highs against the Euro.
- The Australian and New Zealand dollars have tumbled against the USD, falling 3.6% and 5.3%, respectively, reversing some of last year's double digit gains.
- Pacific currencies as a group shed 2.1% against the USD, but gained 1.6% against the AUD as the latter came under added pressure from earlier than expected tightening in China.
- Within the Pacific, the VUV and WST have under-performed thus far this year with losses of 4.3% and 3.3%, respectively, against the USD. The PGK has out-performed the region, with a loss of 0.4% against the USD and a gain of 3.3% against the AUD.

Commodities

- Commodity prices have been volatile of late, with markets flip-flopping between the pull of recovery and the drag of departing accommodative policies. Early brakes applied to Chinese lending and a firming US dollar, courtesy of European sovereigns, added to the uncertainty.
- Crude oil prices rallied to a 52-week high of US\$83/bbl in early Jan buoyed by firmer fundamentals and a colder winter season. However, increased sovereign concerns led to an unexpected strength in the US dollar and crude oil prices eased. The decline in crude oil prices opened up an opportunity for the bulls to enter, as seen from the recent rebound in prices.
- Gold's impressive 2009 rally can to abrupt halt in December, with the rebound in the USD prompting heavy selling off an overbought base. Prices have since steadied.
- Base metals have been on a roller-coaster, influenced by uncertainty over China. This pre-emptive market, which priced-in another strong year of Chinese demand despite swelling inventory levels, covered late in the period as Chinese authorities applied the policy brakes. Prices have since rebounded with the market assessing that the sell-off was overdone.

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FX and Policy Interest Rates

			Current	Mar 10	Jun 10	Sep 10	Dec 10	Mar 11	Jun 11
Fiji	FJD-USD, eop		0.510	0.514	0.505	0.500	0.493	0.483	0.474
	FJD-AUD, eop		0.587	0.578	0.581	0.581	0.580	0.589	0.600
	Short term rates*		4.25	4.25	4.25	4.50	4.75	5.00	5.25
Papua New Guinea	PGK-USD, eop		0.377	0.376	0.370	0.372	0.366	0.363	0.357
	PGK-AUD, eop		0.434	0.422	0.425	0.432	0.430	0.443	0.452
	Short term		7.00	7.00	7.00	7.00	7.00	7.50	8.00
Samoa	WST-USD, eop		0.386	0.398	0.391	0.387	0.383	0.374	0.364
	WST-AUD, eop		0.445	0.447	0.450	0.450	0.451	0.456	0.461
Solomon Islands	USD-SBD, eop		7.907	8.051	8.192	8.313	8.484	8.595	8.595
	AUD-SBD, eop		6.864	7.166	7.127	7.149	7.212	7.048	6.790
Tonga	USD-TOP, eop		1.939	1.912	1.958	1.982	2.012	2.078	2.142
	AUD-TOP, eop		1.683	1.702	1.704	1.705	1.710	1.704	1.692
Vanuatu	USD-VUV, eop		102.24	98.00	100.00	102.00	102.00	105.00	108.00
	AUD-VUV, eop		88.82	87.22	87.00	87.72	86.70	86.10	85.32
	Short term		6.00	6.00	6.25	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, (^) 8 February 2010.

Macroeconomic Forecasts

Real GDP Growth (%)

	2009e	2010f	2011f
Fiji	-2.5	1.8	2.5
PNG	5.0	6.5	6.0
Samoa	-4.3	3.0	5.7
Solomon Is.	0.6	3.4	4.1
Timor-Leste	7.7	7.8	8.0
Tonga	1.5	1.9	2.5
Vanuatu	4.0	4.5	4.5

Nominal GDP (US\$ bn)

	2009e	2010f	2011f
Fiji	3.7	3.9	4.2
PNG	9.1	10.4	12.0
Samoa	0.5	0.6	0.6
Solomon Is.	0.5	0.6	0.6
Timor-Leste	0.5	0.5	0.6
Tonga	0.2	0.2	0.2
Vanuatu	0.6	0.6	0.7

Inflation (%)

	2009e	2010f	2011f
Fiji	4.0	4.8	4.0
PNG	6.9	7.3	6.5
Samoa	6.1	3.5	4.7
Solomon Is.	8.1	8.0	8.5
Timor-Leste	0.1	3.5	5.0
Tonga	2.7	3.8	4.3
Vanuatu	5.2	4.0	3.0

Fiscal Balance (% of GDP)

	2009e	2010f	2011f
Fiji	-3.0	-3.5	-3.0
PNG	0.0	0.2	0.3
Samoa	-14.2	-8.4	-6.0
Solomon Is.	-0.5	-2.0	-3.0
Timor-Leste*	-207.2	-156.8	-115.1
Tonga	-2.8	-2.5	-2.2
Vanuatu	2.0	2.3	2.3

*Non-oil balance

Current Account Balance (% of GDP)

	2009e	2010f	2011f
Fiji	-10.0	-15.0	-13.0
PNG	0.0	-1.8	1.6
Samoa	2.6	-3.6	-3.7
Solomon Is.	-7.0	-10.0	-11.0
Timor-Leste	367.4	483.2	433.9
Tonga	-15.9	-14.8	-14.4
Vanuatu	1.0	-2.0	-4.0

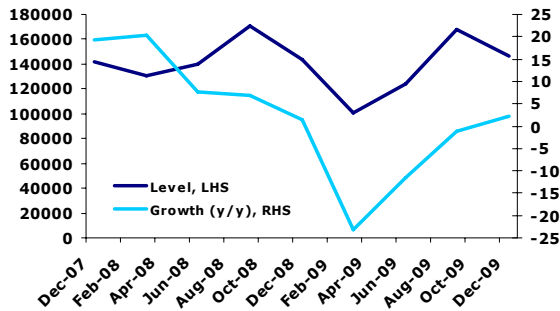
Foreign Exchange Reserve (US\$ mn)

	2009e	2010f	2011f
Fiji	600	575	550
PNG	2,283	2,257	2,394
Samoa	133.1	150.0	169.0
Solomon Is.	145	152	160
Timor-Leste	238	300	350
Tonga	84.8	71.4	68.3
Vanuatu	120	135	145

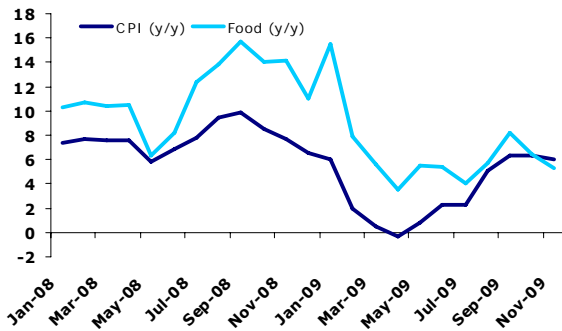
Sources: Asian Development Bank, various country websites, ANZ Economics.

Country Update: Fiji

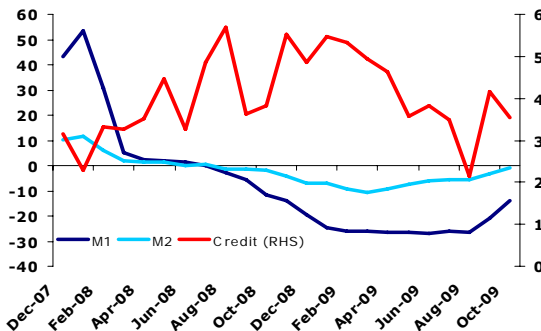
Fiji - Quarterly Tourist Arrivals



Fiji - Inflation



Fiji - Money and Credit Growth (y/y)



Available data suggest the recovery remains weak, although tourist arrivals from Australia have turned around. Inflation continues to rise and has eroded some of the competitiveness gains from the devaluation. Fiji needs a recovery in discretionary demand in its major trading and tourism partners in order for growth to pick up in 2010.

- Real sector data for H2 2009 are sparse, complicating our assessment. Real GDP fell by an estimated 2.5% for 2009 as a whole. Mining activity picked up late in the year.
- Provisional data show that visitor arrivals totalled 539,405 in 2009, a decline of 7.8% for the year compared with 8.4% growth in 2008. Disaggregated data through Q3 show that arrivals from Australia began to rise at mid-year whilst arrivals from the US continued to decline.
- The trade balance continued to improve in Q3. Exports fell by 15½% (y/y) to FJD366mn while imports fell 31% to FJD723mn. The FJD357 trade deficit in Q3 2009 compares with a deficit of FJD616mn in the same period in 2008.
- Inflation rose to 6.8% (y/y) in Dec, compared with 6.0% in Nov, the highest level since late 2008. The rise in inflation was fuelled primarily by increases in food and transportation costs.
- Credit growth fell to 0.6% (y/y) in Dec from 2.6% in Nov, suggesting that the pace of activity remains sluggish. This despite a decline in real lending rates as inflation has risen and nominal rates in 2009 were broadly unchanged.
- The nominal effective exchange rate fell marginally in Dec, and was down 18.9% (y/y). However, the real effective exchange rate was down 14.3%, having risen 7.7% since the devaluation on higher relative inflation.
- Foreign reserves were FJD1.1bn at end-Jan 2010, equivalent to 3½ months of imports. The strong reserve rise since early last year reflects the effects of the devaluation on the trade account as well as an SDR disbursement from the IMF.
- The outlook remains cloudy for Fiji. Positive growth should return this year, but depends heavily on the speed of the global recovery, which we think will be slow. For 2010, we are forecasting GDP growth of 1.8% and average inflation of 4.8%. In the medium-term, political relations with major partners will need to improve.

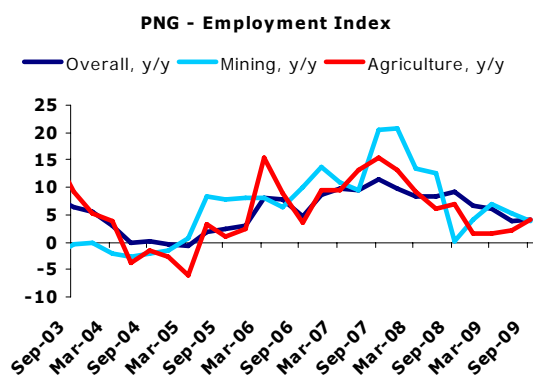
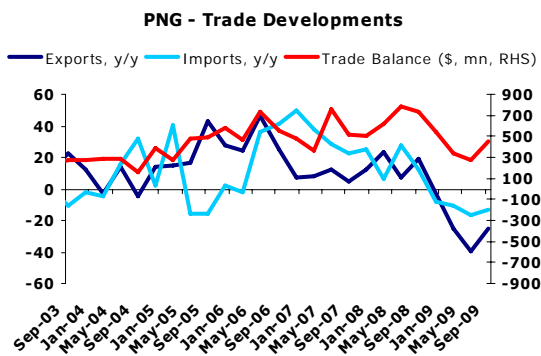
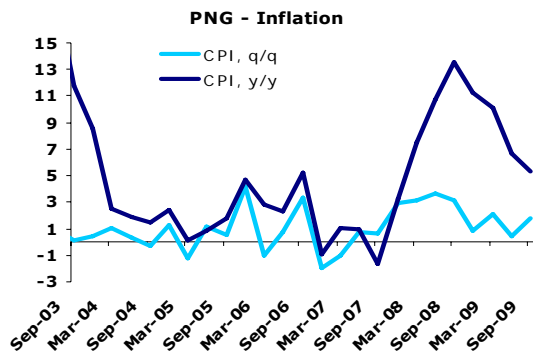
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Economic Data – Fiji

Quarterly data	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09	Sep 09
Consumer Price Index, % YOY	4.3	7.5	6.9	9.8	6.6	0.5	2.3	6.3
Domestic Credit, % YOY	3.2	5.3	3.3	3.6	4.8	4.9	3.8	4.1
Exports, % YOY	-4.0	26.8	20.2	21.3	19.6	-13.0	-24.6	-15.5
Imports, % YOY	2.7	8.6	38.2	40.9	16.1	-0.2	-24.4	-31.1
Trade Balance, US\$ mn	-123	-83	-129	-133	-84	-56	-89	-55
Official Reserves, US\$ mn	518	504	481	429	317	241	318	523

Sources: Reserve Bank of Fiji, ADB, IMF

Country Update: Papua New Guinea



Inflation momentum has picked up at the same time that private sector employment growth has slowed. Following a 100bps rate cut in Dec, BPNG now seems to have turned its focus on inflation.

- The trade surplus widened to PGK1.2bn in Q3 from a five year low of PGK0.7bn in Q2, owing to stronger exports and weaker imports. Exports rose by 14.7% (q/q) to PGK3,057mn, but are still down 24.7% (y/y). Imports dropped by 4% (q/q) to PGK1,861mn, still down 13.5% (y/y). Despite the improvement in the trade balance, PNG's current account deficit has continued to widen, reaching PGK905mn in Sep 2009.
- The Private Sector Employment Index increased by 0.6% (q/q) in Q3, compared with 1.2% and 2.4% in Q2 and Q1, respectively. Increased employment in the manufacturing and mining sectors helped offset a drop in the agricultural and construction sectors.
- The government recorded a budget surplus of PGK551.9mn in the first nine months of 2009. Revenues were broadly on track, while expenditures were down by 5.4% (compared with the same period in 2008) to PGK3,511.9mn, which is roughly half of the budgeted outlays for 2009. The relatively low usage of funds can be attributed to lower development spending.
- Inflation momentum picked up in Sep, rising to 1.0% (q/q) from an average of 0.4% in Q2; the annual rate was 5.5% (y/y). The rise in inflation was broad-based. Meanwhile, broad money growth (M3) slowed to 73% (q/q) in Q3 from 125.6% in Q2. The PGK gained 1.2% against the USD in 2009, but lost 22.1% against the AUD. In trade weighted terms, the PGK gained 87.3% in the first nine months of 2009.
- The Bank of Papua New Guinea cut the Kina Facility Rate by 100bps to 7.0% in Dec and has indicated that this rate will be maintained into Feb 2010. The central bank said that it is mindful of inflation developments from a weaker exchange rate, strong domestic demand and a fast draw down in the government's trust accounts.
- The economic outlook should continue to improve as global trade continues to normalise. We expect GDP growth of 6.5% in 2010 compared with an estimated 5.0% in 2009. Inflation is expected to build, rising to an average 7.3% in 2010 from an estimated 6.9% in 2009.

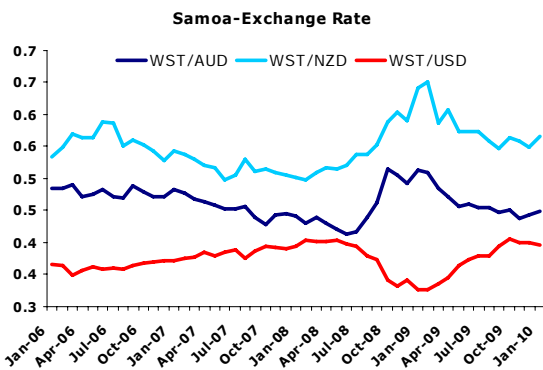
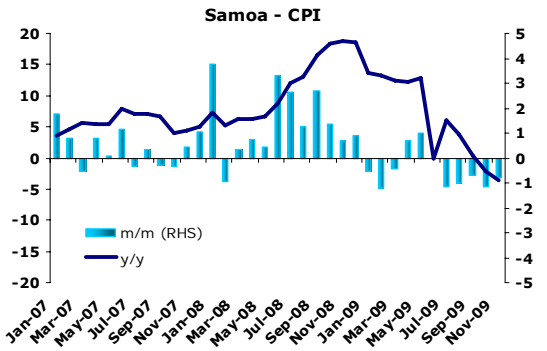
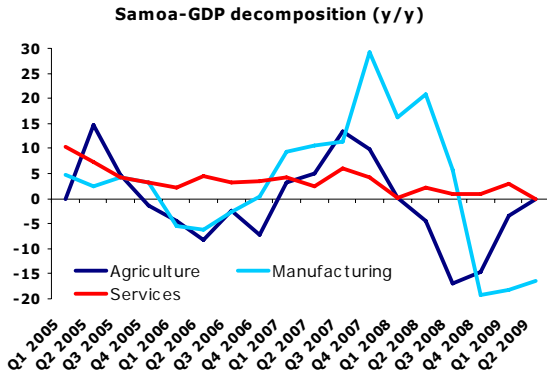
Tamara Henderson

Economic Data – Papua New Guinea

Quarterly data	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09	Sep 09
Employment Index, % YOY	9.6	8.5	8.3	9.3	6.7	6.1	3.9	4.0
Consumer Price Index, % YOY	3.2	7.5	10.7	13.5	11.2	10.1	6.7	5.3
Exports of goods (BOP), % YOY, PGK	12.2	23.2	7.0	19.3	-2.6	-25.3	-39.4	-24.7
Imports of goods (BOP), % YOY, PGK	25.1	6.0	27.3	12.6	-8.3	-10.3	-16.8	-13.5
Trade Balance (BOP), US\$ mn	507	614	790	734	542	344	275	456
Foreign Exchange Reserves, US\$m	2,053	2,039	2,418	2,454	2,093	1,950	2,283	n/a

Source: Bank of Papua New Guinea, ANZ Economics

Country Update: Samoa



Economic performance remained weak in the months following the Sep 2009 tsunami as trade volumes slowed. However, tourist earnings and private remittances, which account for a substantial proportion of the economy, grew in Nov, reflecting the positive outlook. We expect a modest recovery this year.

- GDP fell for the third consecutive quarter in Q2 2009, declining 4.6% (y/y), compared to a revised -3.8% in Q1. The primary and tertiary industry remained relatively resilient, while Samoa's secondary industries continued to decline by 16.4%, albeit less than the -18.2% in Q1.
- Exports fell 5.9% (y/y) in Nov, compared with a 5.5% rise in Oct. Imports fell by 13.6% in Nov from -10.4% the previous month. Monthly trade deficits moved up into the \$19-21mn range in Nov and Oct from the \$14-16mn range observed over most of 2009.
- The tourism industry was badly hit after the tsunami as many travellers cancelled or postponed their bookings. In Nov, tourist arrivals fell by 10.0% (m/m) but increased 9.0% (y/y). That said, holiday makers' confidence seems to have picked up more recently, based on remarks from major tour operators. Tourist earnings in Nov turned positive rising 2.6% (y/y) while remittances grew 13.3%. Remittances and tourism account for roughly 20% of GDP.
- Deflation appeared in Samoa in Q4 as the CPI fell 2.2% (y/y) and 3.6% respectively, in Oct and Nov. The decline in headline CPI was attributed to lower food prices and reductions in the cost of imported fuel. Meanwhile, core CPI also turned negative in Nov, falling by 1.2% compared with Oct's 1.3% gain.
- M2 declined marginally by 0.2% (m/m) in Nov after registering a growth of 2.7% in Oct, mainly due to a 3.0% drop in net foreign assets. However, M1 expanded by 3.1% in Nov, on account of a 6.6% growth in demand deposits
- We expect the slowdown to ease as the negative impact of the tsunami on tourism fades. Trade volumes should also start to rise on the back of the recovering global economy. However, overall economic performance for 2010 is likely to remain sluggish with GDP growth at 3.0%. We see GDP returning to its long-term growth trend in 2011.

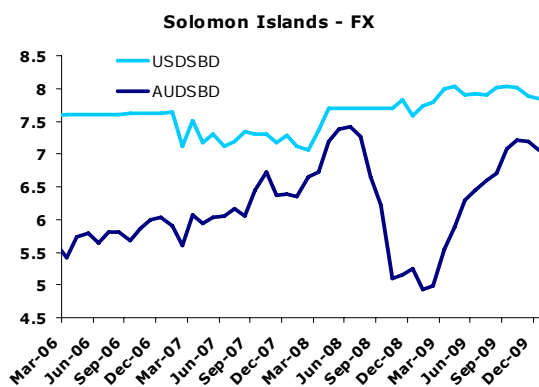
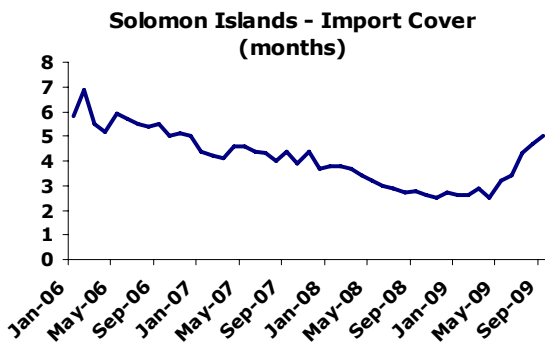
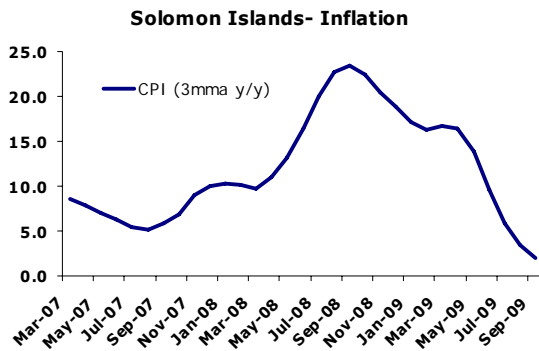
Isaac Thong

Economic Data – Samoa

Quarterly Data	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09	Sep 09
Consumer Price Index, % YOY	4.5	6.3	7.2	13.9	18.4	13.0	9.2	0.3
M2, % YOY	11.0	1.9	12.1	6.9	5.8	18.2	7.7	6.9
Exports, % YOY	42.1	-29.4	-41.0	-29.9	-45.2	47.8	-5.6	26.6
Imports, % YOY	2.9	15.0	-22.3	25.4	22.0	-32.5	-6.2	-37.5
Trade Balance, US\$ mn	-15.6	-19.8	-16.1	-26.1	-19.8	-12.9	-15.1	-15.6
Foreign Exchange Reserves, US\$ mn	90.2	100.6	101.5	90.2	81.3	84.8	100.4	124.5

Sources: Central Bank of Samoa, Samoa Ministry of Finance

Country Update: Solomon Islands



The rebound in activity continues with increases in exports and production levels (especially for logs). Inflation has declined significantly. The fiscal position and foreign reserves have both strengthened due to higher exports and revaluation gains. Meanwhile, the currency has enjoyed a broad-based appreciation.

- Exports surged by 38.6% (m/m) in Dec due to a considerable increase in the shipment of log products. Exports of alluvial gold and palm oil also rose; however, fish and copra exports declined. The balance of payments for Dec recorded a surplus of SBD82.1mn, up sharply from a surplus of SBD26.5mn in Nov.
- Log production rose 42.0% (m/m) in Dec following a 34.0% increase in Nov. However, production was still down 24.0% (y/y). Cocoa production reversed the previous month's gain, falling 35.0% (m/m) in Dec.
- Total transfer receipts doubled to SBD118mn in Dec due to higher transfers to funding agencies and the government. However, transfers to individuals, companies, embassies, churches and NGOs declined.
- Inflation in Sep slowed to 2.0% (y/y) from 3.4% in Aug. The overall decline mirrored drops in both local and imported components.
- Total domestic credit declined by 1.0% (m/m) in Dec due to a 30.8% drop in net credit to the government. On the other hand, credit to the private sector rose by 1.0%. M3 rose by 6.5%, driven by a rise in net foreign assets.
- The government's total debt stock declined to SBD1425.1mn in Dec from SBD1446.3mn in Nov due to debt repayments and exchange rate movements.
- The SBD remained stable against the USD for the ninth consecutive month. However, it appreciated against other major currencies including AUD, GBP, and JPY.
- Official foreign reserves rose by 7.6% (m/m) to SBD1162.5mn in Dec. This is equivalent to 4.8 months of imports of goods and non-factor services.

Eesh Mengi

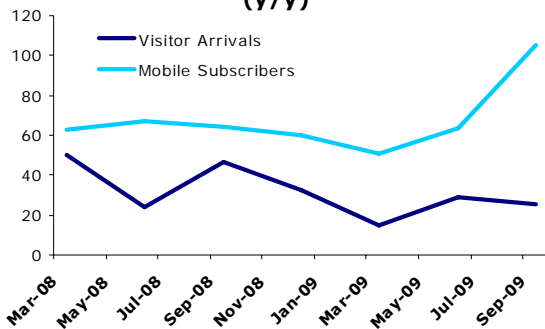
Economic Data – Solomon Islands

Quarterly Data	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09	Sep 09
Domestic Credit, % YOY	62.0	60.1	74.4	56.6	47.8	63.3	35.9	39.0
Consumer Price Index, % YOY	8.6	6.3	5.8	10.0	9.7	16.5	23.5	19.4
Exports, % YOY	52.6	9.7	35.1	72.3	24.0	93.6	44.5	-14.0
Imports, % YOY	44.5	21.7	27.5	39.2	1.4	34.9	13.5	-31.0
Trade Balance, US\$ mn	-33.5	-33.0	-36.7	-31.7	-27.2	-23.1	-26.5	-87.5
Foreign Exchange Reserves, US\$	100.9	118.4	124.1	127.8	117.9	100.8	98.3	93.3

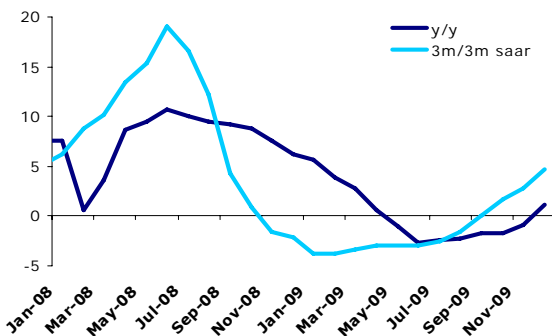
Sources: National Directorate of Statistics, Economist Intelligence Unit

Country Update: Timor-Leste

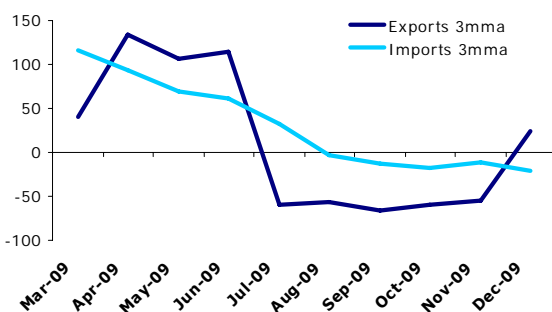
Timor-Leste - Activity Indicators (y/y)



Timor-Leste - Inflation



Timor-Leste - Trade Developments(y/y)



The 2010 growth outlook for Timor-Leste is generally positive. While the impulse from government spending is likely to be negative this year, the economy remains on a solid footing with activity indicators such as credit growth and net exports picking up and consumption momentum strengthening significantly.

- Consumption indicators are steaming ahead. The number of mobile subscribers rose by 105.5% (y/y) in Q3 2009, nearly double the average growth rate over the previous year. Motorcycle registrations rose 82.7% (y/y, ytd) in Q3 2009, signalling that household spending is rising fast. However, visitor arrivals' growth remains weak.
- The decline in exports narrowed to 18.2% (y/y) in Q4 from -66.9% in Q3, helped by a rebound in re-exports as well as recovering coffee shipments, which had been adversely affected by poor weather last year. Total imports fell 22.6% (y/y) in Q4, down from -14.5% in Q3. This was due to a slowdown in government expenditures of capital goods, machinery and vehicles owing largely to base effects.
- Headline inflation remains low at 1.1% (y/y) in Dec, but our short-term 'momentum' measure showed that inflationary pressures are returning with food prices showing the largest increase.
- Credit growth appears to be normalising, increasing by 6.0% (q/q) for Q3 2009, up from 2.2% in Q2. Credit to the construction sector showed the largest rebound, increasing by 75.9% in Q3 compared with -18.6% in Q2. Credit to the trade and finance sector also grew 37.5%.
- The 2010 Budget calls for \$549mn of self-funded expenditure, a slight drop from the 2009 level of \$589mn. Given an upward revision of the estimated sustainable income from the state Petroleum Fund (to \$502mn) and likely underspending of budget allocation (as per 2008), there may not be a need for a drawdown of the Fund. We see future growth to require support from new drivers besides expanding government expenditure.
- Indonesia and Timor-Leste have signed an agreement for greater co-operation among co-ops and SMEs in the two countries. This will be helpful in supporting trade as well as generating new business partnerships going forward.

Chang Wei Liang

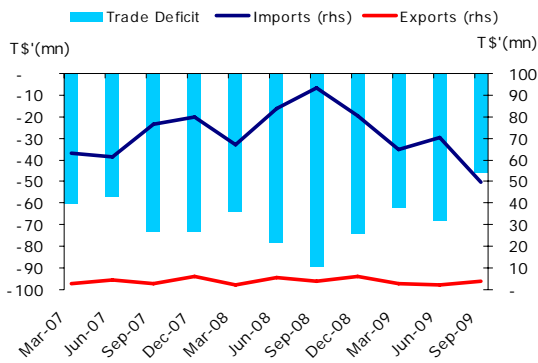
Economic Data – Timor-Leste

Quarterly Data	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09	Sep 09	Dec-09
Mobile Subscribers, % YOY	63.1	67.2	61.2	59.8	50.9	63.3	105.5	n/a
Visitor Arrivals, % YOY	50.2	24.1	46.8	32.7	14.6	29.1	25.6	n/a
Consumer Price Index, % YOY	3.7	10.7	9.1	6.1	2.8	-2.7	-1.7	1.1
Exports, US\$ mn	10.3	7.1	19.2	11.3	7.0	12.0	6.3	9.2
Imports, US\$ mn	43.3	49.5	68.2	85.7	93.2	77.2	58.3	66.4
Trade Balance, US\$ mn	-33.0	-42.5	-49.0	-74.4	-86.2	-65.2	-52.0	-57.2

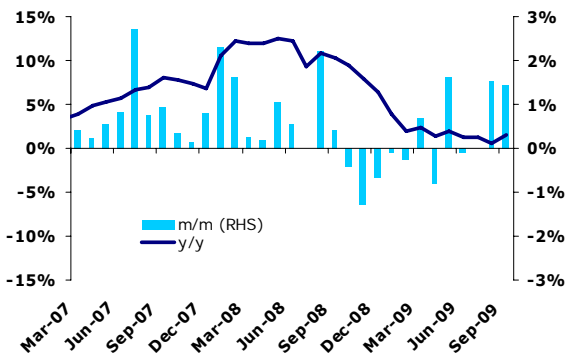
Sources: National Directorate of Statistics, Economist Intelligence Unit

Country Update: Tonga

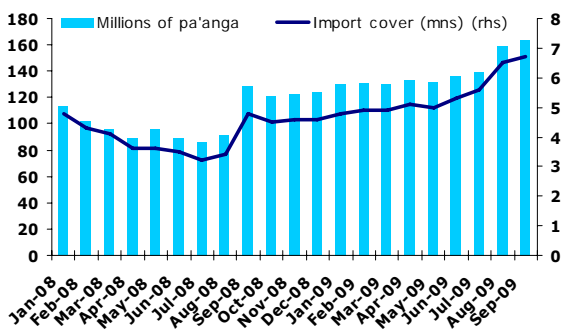
Tonga - Trade Developments



Tonga - CPI



Tonga - Foreign Reserves



The outlook for Tonga remains uncertain as exports, tourist receipts and remittances are still weakening. The recovery is largely dependent on the global economy with more than one-third of Tonga's fx inflows related to tourism and remittances.

- The trade deficit remains large as Nov's exports growth remained negative at -28.1% (y/y), following a 35.6% decline in Oct. Imports fell 23.9% in Nov compared with a 24.6% decline in Oct.
- Private credit fell 10.5% (y/y) in Nov as household and business borrowings fell 4.3% and 15.1% respectively. Banks have indicated that they will consolidate their lending portfolio and focus on recovering bad debts. Therefore, lending growth will likely be slow to pick up.
- Tourist receipts declined sharply in Oct and Nov, falling by 22.9% (y/y) and 22.8% respectively. This is in stark contrast to the 46.3% and 69.1% growth achieved in Nov and Oct of 2008.
- Private remittances declined by 0.4% (m/m) in Nov to TOP156.9mn. On an annual basis, private remittances growth remained negative, at -16.1%.
- Inflation rose from a historic low of -0.4% (y/y) in Oct to 0.4% in Nov. Rising inflation is largely attributed to increasing domestic prices offsetting falling import prices of goods and services. Inflation is most likely to rise going forward on higher food and fuel prices.
- Official foreign reserves rose fractionally to TOP160.4mn in Dec. On an annual basis, foreign reserves jumped by 36.5%. The current level of reserves covers 6.8 months of imports, significantly higher than 4.6 months in 2008.
- Tonga's output gap is likely to remain negative as the underlying drivers for growth remain weak. Private credit tightening will have a negative impact on overall demand. Tourist receipts and remittances will improve marginally with a modest global recovery underway.
- Cyclone Rene struck Tonga on 14 Feb. Tongatapu, the main island, apparently escaped the worst of the storm, although it is too early to assess the full damage.

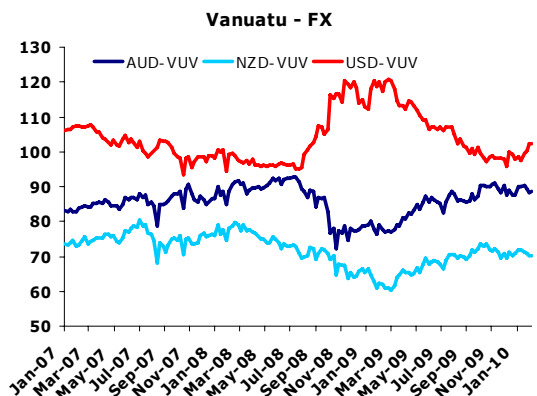
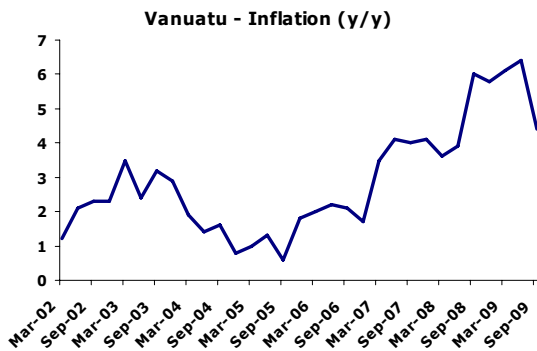
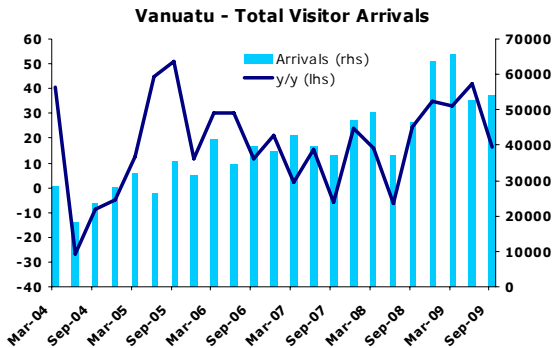
Shuzhen Pay

Economic Data – Tonga

Quarterly Data	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09	Sep 09
Consumer Price Index, % YOY	7.30	11.59	12.24	10.15	7.69	2.39	1.24	1.57
Private Sector Credit, % YOY	16.3	16.3	16.3	16.3	16.3	16.3	16.3	16.3
Exports, % YOY	-63.2	1.09	27.18	28.42	-7.12	13.59	-61.31	-6.36
Imports, % YOY	-25.8	6.1	36.0	22.0	0.8	-2.8	-15.7	-46.7
Trade Balance, US\$ mn	-73.2	-64.4	-78.1	-89.3	-74.3	-62.1	-68.4	-46.0
Foreign Exchange Reserves, US\$ mn	60.9	53.49	49.4	65.5	58.1	60.3	66.1	85.1

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

Country Update: Vanuatu



Economic activity improved in Q3, led by a recovery in the construction and services sectors. Despite ongoing weakness in global travel, Vanuatu continued to attract tourists, mainly from the regional markets. This underpinned activity in the tourism-related and construction sectors, offsetting weakness in the commodity sector.

- The trade deficit widened to VUV4.5bn in Q3, up from 4.2bn in Q2. Total exports grew by 5.9% (q/q) in Q3, but imports outpaced at 9.0% growth, in part reflecting higher import bill owing to a stronger AUD. The current account registered an almost VUV2bn swing to a surplus of 929mn, supported by buoyant tourism receipts and inbound transfers.
- Visitor arrivals grew by a modest 2.0% (q/q) in Q3 on lower cruise calls, but on a y/y basis rose 16.5%. A seasonal surge in air arrivals, mainly from Australia and New Zealand, kept tourism activity strong.
- The CPI rose 4.4% (y/y) in Q3, against a revised 6.4% rise in Q2. In q/q terms, prices rose 0.4%, the slowest pace in three quarters. The pass-through from lower global food and fuel prices in H1 2009 resulted in the slowing CPI momentum, according to the RBV. The central bank expects inflation to return to its target range of 0% to 4% in 2010, down from a projected 4.6% rise in 2009.
- The VUV strengthened by around 3% against the USD in Q4 on a sustained improvement in global risk appetite, but currency gains lagged behind the AUD and NZD. The recent pullback in risk appetite, however, saw VUV erasing all its gains against the USD in the past quarter.
- Foreign reserves were down slightly to VUV11.6bn in November, with import cover falling to 5.2 months from 5.8 in Q2. The official target is 4 months of import cover.
- The RBV held the rediscount rate unchanged at 6.00% as the economy continued to perform broadly as expected. Weaker-than-expected performance in the commodity sector was offset by a faster recovery in Australia, Vanuatu’s key external market.
- Economic performance is likely to improve in 2010. The services sector will continue to be the main driver of growth, benefiting from Vanuatu’s proximity to major tourist markets in the region. The recovery in global soft commodity prices should also ease the drag on economic growth. The series of earthquakes in recent months is unlikely to have a material impact on growth this year.

Yeo Han Sia

Economic Data – Vanuatu

Quarterly Data	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09	Sep 09
Consumer Price Index, % YOY	4.1	3.6	3.9	6.0	5.8	6.1	6.4	4.4
Exports, % YOY	47.2	49.4	37.3	46.3	63.6	65.6	52.9	53.9
Imports, % YOY	-24.2	66.8	26.0	54.7	36.5	259.8	26.9	-29.8
Trade Balance, US\$ mn	11.5	49.3	36.2	36.7	23.5	-14.8	-16.3	-14.7
Foreign Exchange Reserves, US\$ mn	117.6	119.0	119.3	111.8	112.7	105.5	115.4	116.5

Sources: Reserve Bank of Vanuatu, ANZ Economics

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