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Focus on Papua New Guinea and Fiji

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Inside:

Authors:

Amy Auster
Head of International Economics
+61 3 9273 5417
Amy.Auster@anz.com

Jasmine Robinson
Senior Economist International
+61 3 9273 6289
Jasmine.Robinson@anz.com

Katie Dean
Senior Economist, International
+61 3 9273 1381
Katie.Dean@anz.com

Dr Alex Joiner
Economist, International
+61 3 9273 6123
Alex.Joiner@anz.com

Our Vision:

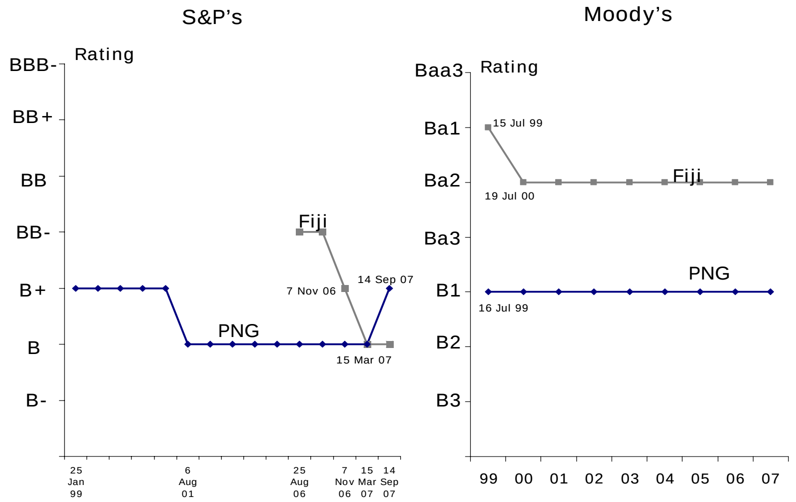
For Economics@ANZ to be the most respected, sought-after and commercially valued source of economics research and information on Australia, New Zealand, the Pacific and Asia.

The theme article in this report focuses on developments in the two largest economies in the Pacific region, Fiji and Papua New Guinea. Both countries have experienced watershed years in 2007 in terms of economic and political events, and while we regularly update economic data in this publication it seems an opportune time to examine recent developments in greater depth.

Papua New Guinea and Fiji are trending in opposite directions in many ways, with the economy of PNG experiencing robust growth thanks to the mining boom, while the economy of Fiji will likely contract this year. Political developments are also at odds, with PNG having experienced a smoother-than-expected parliamentary election over the past month while Fiji is experiencing a high degree of uncertainty around the return to democratic rule. The concern in Fiji is that political uncertainty and the tenuous nature of the government will prevent much-needed attention to policies that would re-invigorate the economy and slow the deterioration in Fiji's macroeconomic stability.

Papua New Guinea's positive economic prospects, including improved economic management by the Treasury and the Bank of Papua New Guinea, have led to continued improvements in creditworthiness. If present trends continue with strong growth, fiscal discipline and stable government, it seems possible for the credit rating of PNG to be upgraded to "BB" territory within the next 12-24 months. In contrast, Fiji's creditworthiness has already deteriorated as a result of economic stagnation and political uncertainty, with the credit rating by S&P's downgraded this year by 1 notch to B.

History of Long term Foreign Currency Government Bond Ratings



Sources: Standard & Poor's, Moody's Investors Service

The following report details the expectations for the economies of PNG and Fiji in the coming year. In PNG, a continued inflow of investment into the mining sector should see growth accelerate to more than 4% this year and next, amid improving infrastructure and rising wealth. The main risk to the PNG economy is inflation, and the likelihood that interest rates will eventually have to rise in order to contain inflation risks. In Fiji, the government is now anticipating that the economy will contract by 3.1% this year and there appears little on the horizon to bring about a great improvement for next year. Credit conditions will remain tight so long as the balance of payments is under pressure. An adjustment to the exchange rate regime would help give the economy room to expand, but this seems unlikely to eventuate in the present environment.

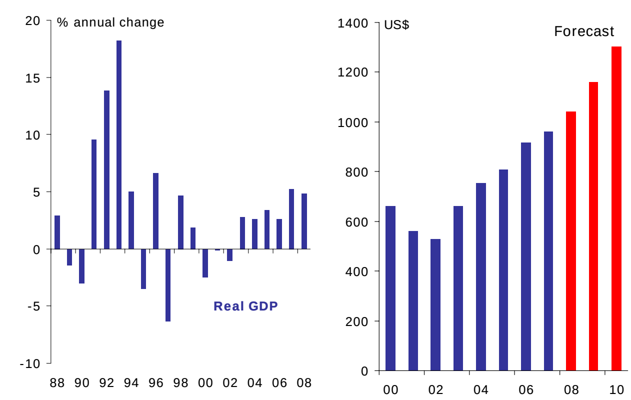
PNG: Strong growth amid stability

The government is forecasting that real GDP growth will reach 5.25% per annum this year, significantly higher than what was forecast at the beginning of the year. Tracking growth in PNG is difficult due to the absence of data, as the national accounts data were last released for 2002. The best proxy for growth appears to be the Bank of Papua New Guinea's employment index, which rose by 9.8% per annum in the March quarter. Although no updated data have been released as yet, economic activity appears to have remained robust, and it seems likely that nominal GDP growth was well in excess of 7% per annum.

The last time that real GDP growth exceeded 5% in PNG was in 1996, making this a 10-year high. More importantly, 2007 marks the fifth consecutive year of positive real GDP growth in PNG, the first time this has occurred since independence according to available data. The importance of this steady rate of growth to the welfare of the people of PNG should not be underestimated; if real GDP growth rises 3.5% next year, and the exchange rate holds roughly steady, GDP per capita will exceed US$1,000 in PNG for the first time.[1]

Solid GDP growth means real wealth gains

GDP growth | GDP per capita



Source: BPNG

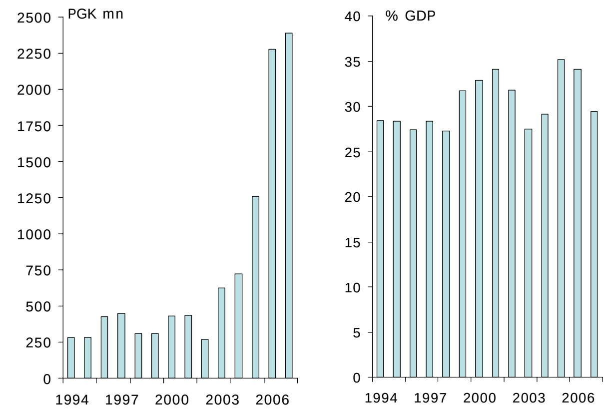
The solid growth rate in PNG is mainly thanks to the commodity price boom, which has seen PNG's trade surplus quadruple from just US$541 mn in 2002 to US$2.2 bn last year. Over this time, the export price index has more than doubled. Although the lack of an import price index makes it impossible to calculate the "terms of trade" (the ratio of export to import prices), it is evident that PNG is experiencing a classic terms of trade boom. Minerals export prices surged 43% last year for PNG's exports of oil, gas, copper and gold. More importantly for the broad economy, the agricultural sector that employs as much as 80% of the population has also seen rising prices, with coffee, copra, palm oil and logs all up more than 10% per annum as of the end of the March quarter. Export volume indices show falls in coffee, palm oil and logs in Q1 2007, but the employment index shows nearly 10% annual growth in the agricultural sector in the March quarter.

[1] Assumes 3.5% real GDP growth in 2008; an average exchange rate of USD/PNG0.33 and a population of 6.45 mn.

At the same time, the economy is reaping the dividends of greatly improved macroeconomic management. Reforms over the past five years have seen the government slash its debt levels from 57% of GDP in 2000 to less than 40% of GDP at present. In addition, the replacement of foreign currency debt with its local currency equivalent has reduced the government's vulnerability to any future external shocks. Surging government revenues due to increased company taxes and minerals-related royalty payments have made it easier to improve fiscal balances and reduce government debt than might otherwise have been the case. Nonetheless, the fiscal discipline has been impressive, as government expenditure as a percentage of GDP has lagged far behind the growth in revenues. In 2006, government revenues were equivalent to 43% of GDP and are expected to remain at around these levels this year, while expenditure has been 30-34% of GDP. According to the Treasury's mid-year review, government expenditure will be limited to below 30% of GDP this year, resulting in a fiscal surplus of more than 6% of GDP.

Government has maintained discipline

Minerals payments to government | Government expenditure



Source: BPNG

The decline in government debt has helped to lower inflation and interest rates, while at the same time allowing more credit to be available for the private sector. Over the past five years, inflation has fallen from more than 20% YOY to below 5% YOY, allowing the benchmark kina facility rate (KFR) to decline from 15% per annum to 6.0% per annum.

Election proceeds smoothly

As the economy improved over the past few years, one of the key uncertainties on the horizon was always the 2007 national elections. The political history over 30+ years since independence has been marred by very unstable government, with fractious political parties and constant votes of no confidence preventing any government from reaching its full term in office. The past five years broke that trend, following a series of political reforms and a good record of economic management. The concern was that the elections of 2007 presented the risk of a return to unstable government that would return the economy to a state of disrepair.

In the event, the elections of August-September took place much more smoothly than many had feared. The election was broadly peaceful, especially relative to past elections where tribal warfare has led to serious electoral disturbances. The governing National Alliance (NA) was returned to power with 27 seats, the highest it has achieved. The legislated moratorium period following the election during which there can be no vote of no confidence now lasts until January 2009, implying that there is at least 18 more months of political stability to come.

Politics are still messy, however. The NA has 27 seats, but there are 109 parliament and independents have garnered 20 seats, making them the second-largest majority. The need for coalitions raises the risk of fractional politics, and there is indication that the number of ministerial portfolios will rise from 28 under the last government to more than 30. There are also discussions of another supplementary budget, which poses the risk of raising inflation pressure unless the expenditure is mainly on investment such as infrastructure (see below).

Other pending issues include resolution of the Julian Moti affair and a court case alleging that National Alliance leader Sir Michael Somare can no longer serve as NA parliamentary leader since he has served 2 consecutive terms. Hence, disqualifying him to be Prime Minister. A combination of the Somare challenge and coalition politics raises the risks of an early change of government, or at least leadership, prior to the next elections scheduled for 2012. Nonetheless, the fact that PNG has accomplished a smooth political transition to a new government through election is an important milestone, and the evidence of what can be achieved under a stable government should help lower the political will to cause future instability.

S&P upgrades PNG rating

The success of the election, combined with continued macroeconomic stability and falling debt levels, prompted S&P to upgrade its rating for PNG in September. S&P raised the long-term foreign currency rating from "B" to "B+", bringing its rating on par with that of Moody's and to the same level at which PNG rates Cambodia, Argentina and Pakistan.

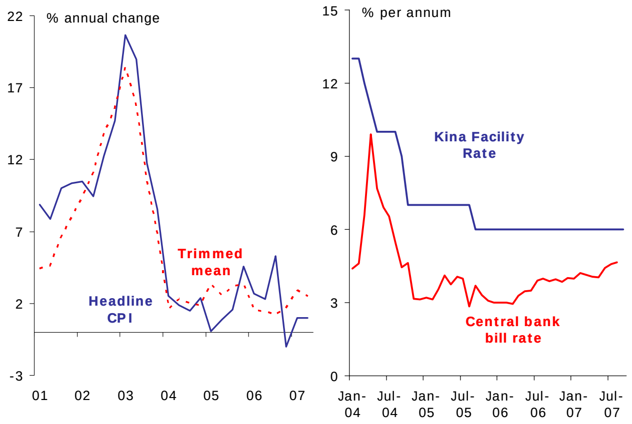
If the political situation remains stable over the next few years and economic performance continues at its current level, there would be a strong argument for another upgrade to Ba3/BB- within the next 1-2 years, in our view. Such ratings upgrades are important as they lower the risk premium associated with offshore funding of investments in PNG, as well insurances costs[2].

Inflation is main risk

From an economic point of view, the key risk on the horizon is higher inflation and interest rates despite the recent revisions to the December quarter 2006 and March quarter 2007 data.

Apart from elevated fuel prices, higher inflation expectations are also most likely being driven by inflows of investment into PNG, which are boosting local incomes and causing the economy to boom. Monetary aggregates show a clear picture of rising liquidity, with private sector credit growth still increasing at more than 30% per annum as of June 2007, and the monetary base expanding at roughly the same rate. This pace of growth over nearly an entire year cannot solely be blamed on the exchange rate (tradeables inflation), and it does provide the fuel to raise inflation expectations when economic growth is so strong. At the same time of healthy growth and rising liquidity, interest rates have remained at historic lows, with the kina facility rate at 6.0% since 2005. Although the central bank bill rate has risen from below 3% in early 2006 to 4.65% as of July, these rises have not been reflected in the benchmark interest rate. PNG's interest rate path is also at odds with rising global interest rates, particularly in PNG's key trading partners of Australia and New Zealand.

Inflation is rising; interest rates may follow



While the BPNG has most recently used the kina to try to manage inflation expectations, there is still a strong probability that the central bank will need to raise interest rates and seek to reduce liquidity in the market in order to contain inflation expectations. We expect the Kina Facility Rate to rise to 6.5% by mid-2008. This, however, should not pose a real threat to growth. The main risk to growth would be for the government to fail to act on inflation – whether by loosening fiscal policy, or by leaving interest rates at historic lows, or both.

Fiji – economy constrained by policy uncertainty

The Fijian economy is headed deeper into recession with the Asian Development Bank revising its forecast to match the official projection for 2007 of -3.1%. Real GDP is forecast to recover in 2008 but growth is expected to remain sluggish at around 1.5-2% over the medium term if structural reform does not gain momentum and investment stays weak amidst an uncertain political environment.

Central bank action helps to alleviate balance of payments pressures

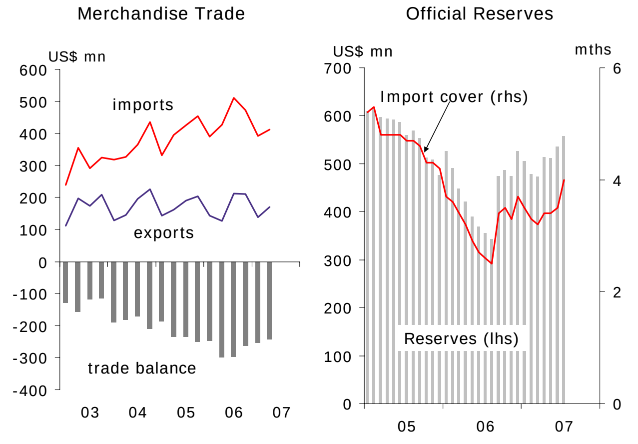
In contrast to the rapid accumulation of reserves that PNG has recorded in recent years, Fiji has experienced a significant erosion in reserves in recent years. This highlights the lacklustre performance of its top two exports, namely sugar

[2] Thanks to Bora Bora, ANZ PNG, for his contribution to this report.

and garments while imports have soared. However, partial data suggests that measures imposed to restrain credit and capital outflows are beginning to bear fruit.

Fiji had already been facing balance of payments concerns prior to the December 2006 coup with deteriorating trade balances exerting pressure on foreign exchange reserves. The latest available data on international reserves recorded by the IMF dates back to October 2006 when they were around US$253 mn, equivalent to less than 2 months of goods imports. This was lower than the official data[3] of US$487 mn (FJ$840 mn) recorded for the same month providing an import cover of 3.5 months. According to official estimates, reserves have since edged up to a provisional US$558 mn (F$877.3 mn) as at July 2007, sufficient to cover 4 months of imports.

Trade deficit narrows and reserves recover



Sources: Datastream, Fiji Islands Bureau of Statistics, Reserve Bank of Fiji

This improvement can largely be attributable to central bank action to restrict capital outflows and tighten credit conditions as well as more subdued investment and labour market conditions.

Wide-ranging exchange controls were put in place in December 2006 in a bid to stem excessive foreign exchange outflows amidst a difficult political environment. These covered import payments, loan repayments, travel allowance and went as far as subscriptions, medical, education and wedding expenses. Measures to restrict local borrowing by non-residents have also been announced. To take effect from 1 January 2008, new borrowings by non-resident firms will be dependent on the concentration of ownership (see table below) with fully foreign-owned companies only allowed to borrow up to 50% of total funding needs locally. Non-resident individuals will not be able to borrow from domestic sources to purchase properties, except to already-approved tourism-related projects.

[3] On 19 July 2005, the Reserve Bank of Fiji announced that foreign reserves would be recorded under a new definition and would include foreign reserves held by other local institutions such as the Fiji National Provident Fund.

New borrowings by non resident companies

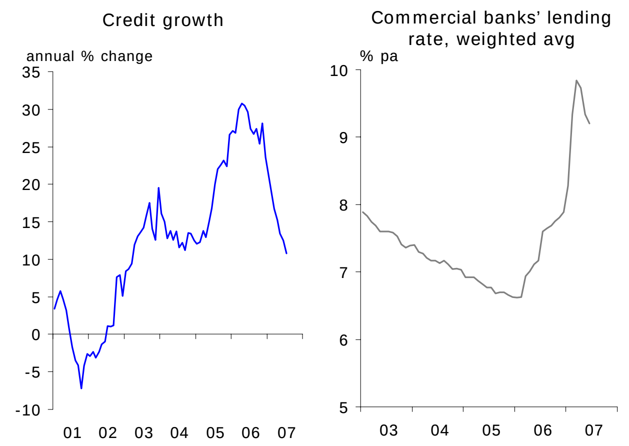
Non-resident ownership	Local borrowing threshold
51-70%	Up to 75%
71-90%	Up to 65%
91-100%	Up to 50%

Source: Reserve Bank of Fiji

Apart from exchange control measures, the central bank also imposed a ceiling on loans by commercial banks to the private sector to be held at or below levels prevailing at 30 November 2006. However, it has allowed banks to exceed this ceiling only for lending to priority areas such as to small and medium-sized enterprises.

The key policy rate has remained unchanged at 4.25% since June 2006. However, commercial banks' lending rates, in weighted average terms, crept up to 9.8%, as of March 2007 from 6.94% in March 2006, although they have since eased to 9.2% as of June 2007. From 1 May, the Reserve Bank also reduced the statutory reserve deposit ratio that commercial banks hold with the central bank from 7% to 6% to help improve liquidity conditions and facilitate a reduction in interest rates. Credit growth has slowed considerably to an annual rate of 10.8% as of July 2007 compared with an average annual rate of 28% in 2006 according to the IMF.

Credit growth slows



Sources: Datastream, IMF, Reserve Bank of Fiji

Fiji's balance of payments is difficult to read. While the current account deficit over recent years has been large (approx. 13-21% of GDP), "net errors and omissions" data, which collates unrecorded flows, has been hugely positive (ie. unrecorded inflows). Nevertheless, financing the current account shortfall, even if overstated, will remain a challenge. According to latest data from the Fiji Islands Bureau of Statistics, the current account is estimated to have stayed in deficit in the first quarter of US$170.6 mn (FJ$285.3 mn). There is, however, likely to be a reduction in the deficit in the coming quarters if the merchandise trade shortfall continues to narrow and tourism earnings recover.

The slowdown in credit growth has seen import growth ease this year. For the first seven months of this year, imports were down 2.5% against the same period in 2006, in US dollar terms. While official data show that reserves have improved, the prospects for a strong pick-up in foreign exchange earnings are limited. Goods exports have ticked up but they are expected to continue to under-perform and the currency's strength has also constrained export competitiveness. Since the start of the year, the Fiji dollar has gained 3.8% against the US dollar and the real effective exchange rate has also edged up. Services receipts generated mainly from tourism are unlikely to record a strong turnaround this year, given lower-than-expected visitor arrivals thus far, and current transfers such as remittances have lagged. Provisional estimates indicate that gross earnings from tourism were down 10% YOY in the first quarter. International aid is also expected to continue to be withheld until elections are called.

Fiji rating downgraded

Against the uncertain political and economic backdrop and external financing pressures, S&P downgraded its long-term foreign currency credit rating of Fiji in March 2007 to B and assigned a negative outlook on the rating. This represented a further downgrade following from that in November 2006. It is now one notch below PNG. Moody's has held its Ba2 foreign currency government bond rating for Fiji but downgraded the outlook to negative in December 2006.

S&P's sovereign risk indicators

2007f	B Median	Fiji	PNG
Real GDP growth (%)	5.3	-2.6	3.5
GDP per capita (US$)	1,248	3,147	736
Inflation (yr avg, %)	6.0	3.0	2.0
Fiscal surplus/deficit (% GDP)	-2.1	-2.1	1.7
- Expenditure (% GDP)			
- Revenue (% GDP)	24.4	31.1	42.3
- Interest payments (% GDP)	2.1	3.0	2.2
Gross debt (% GDP)	41.2	57.0	53.4
Current Account Receipts (% GDP)	46.0	72.8	83.6
Current Account Balance (% GDP)	-6.9	-18.6	5.4
Reserves/Current Account Payments (mths)	2.9	1.6	3.9
Gross external debt/Current Account Receipts (%)	112.2	94.3	45.9

Source: Standard & Poor's

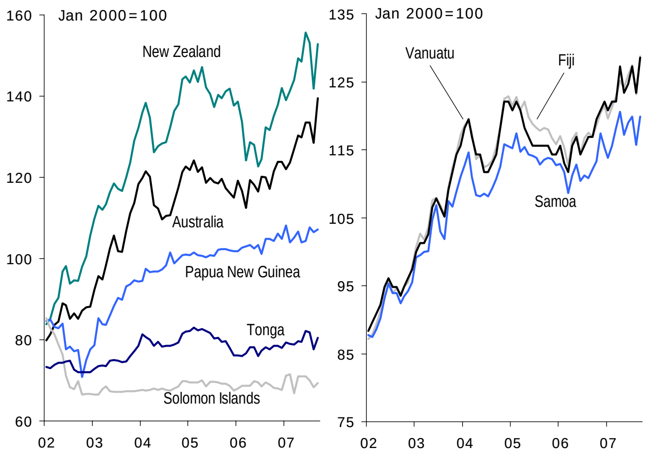
The current volatility in global financial markets and re-pricing of risk means tougher times for current account deficit countries, like Fiji, as global liquidity tightens. Fiji's external balance, while showing tentative signs of improvement, is not out of the woods yet. This, together with the uncertain domestic political and economic policy environment suggests that it will continue to be a difficult road ahead for Fiji.

Amy Auster
Head of International Economics
Amy.Auster@anz.com
+61 3 9273 5417

Jasmine Robinson
Senior economist, International
Jasmine.Robinson@anz.com
+61 3 9273 6289

Financial Markets Update

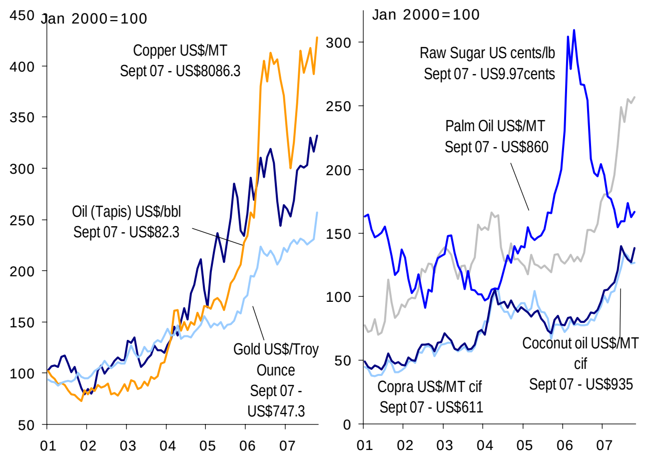
Exchange rates vs US dollar



Exchange rates

- The Papua New Guinea kina continues to edge upwards on the back of the strong prices of its key commodity exports, gold, copper and oil. However, the kina, along with the heavily managed Tongan and Solomon Islands currencies have appreciated only marginally when compared to the currencies of their largest import suppliers, Australia and New Zealand. This may fuel imported inflation in these economies.
- The exchange rates of Vanuatu, Fiji and Samoa have all appreciated in line with moves in the Australian and New Zealand dollars in recent months. However, this steep appreciation has made exports less competitive and may encourage more imports which could lead to further weakness in their trade balances.

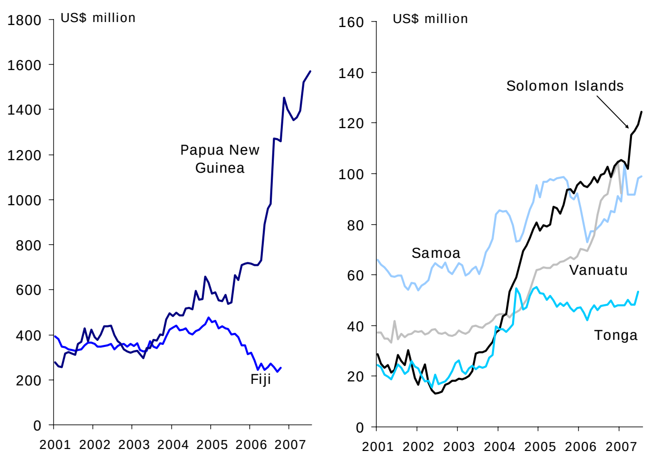
Commodity Prices



Commodities

- Tapis oil prices soared this month as the West Texas Intermediate oil price hit a record high above US$82/bbl. In this market, the combination of lower US oil inventories and the threat of seasonal storm activity in the Gulf of Mexico have more than outweighed concerns about softer US demand.
- Coconut and palm oil have followed the rise in oil prices due to their increasing use as a biofuel in addition to being a food oil. Copra price has followed the rise in coconut oil prices which may bring some trade benefits to many Pacific Island producers.
- Gold prices have also boomed this month, smashing through US$700/oz, to trade as high as US$735 last week. The sharply weaker US$ has been the main driver of the rise in gold, as investors seek an alternative 'store of value'.

International Reserves



International Reserve positions

- Foreign exchange reserves in PNG have resumed what has been a meteoric rise. Reserves have been well supported by the strong performance of commodity exports, with copper prices remaining elevated and significant increases in gold and oil prices.
- Foreign exchange reserves in the Solomon Islands have been given a boost recently with significant increases in foreign aid from New Zealand and Australia following the tsunami earlier in the year. The funding of development projects by Taiwan has also added to reserves.
- The appreciating currencies of Vanuatu and Samoa may fuel imports to the extent that downward pressure is exerted on reserves. This may offset increases in these countries from tourism and remittance inflows.

FX and Policy Interest Rate Forecasts

	Jun 07	Sep 07	Oct 07	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08
Fiji								
FJD/USD, eop	0.628	0.637	0.645	0.641	0.645	0.648	0.645	0.636
FJD/AUD, eop	0.74	0.72	0.73	0.73	0.72	0.70	0.70	0.71
Short term rates*	4.25	4.25	4.25	4.25	4.25	4.25	4.25	4.25
PNG								
PGK/USD, eop	0.333	0.346	0.346	0.345	0.343	0.34	0.338	0.335
PGK/AUD, eop	0.392	0.39	0.391	0.392	0.381	0.370	0.367	0.372
Short term rates**	6.0	6.0	6.0	6.0	6.0	6.5	6.5	6.5
Samoa								
WST/USD, eop	0.386	0.40	0.399	0.397	0.404	0.411	0.411	0.406
WST/AUD, eop	0.454	0.451	0.451	0.452	0.449	0.446	0.447	0.451
Tonga								
USD/TOP, eop	1.91	1.94	1.94	1.93	1.93	1.92	1.92	1.94
AUD/TOP, eop	1.62	1.72	1.72	1.70	1.74	1.77	1.77	1.75
Vanuatu								
USD/VUV, eop	104.8	105.7	99.8	100.2	98.5	96.9	96.9	98.5
AUD/VUV, eop	86.7	86.4	88.3	88.2	88.7	89.2	89.2	88.7
Short term rates***	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0

+:The source of the 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 Repo Facility (KFR); ***: Discount rate

Macro Economic Forecasts

Real GDP Growth (%)

	2005	2006e	2007f
Fiji	0.7	3.6	-3.1
PNG	3.4	3.7	5.3
Samoa	5.2	2.6	4.5
Timor-Leste+	2.3	-1.6	22
Tonga*	0.7	-3.5	0.5
Vanuatu	6.8	7.2	5.5

Nominal GDP (US$ bn)

	2005	2006e	2007f
Fiji	2.41	2.55	2.60
PNG	4.89	5.24	5.93
Samoa	0.42	0.45	0.48
Timor-Leste+	0.35	0.49	0.53
Tonga*	0.22	0.23	0.24
Vanuatu	0.368	0.401	0.418

Inflation (%)

	2005	2006e	2007f
Fiji	2.4	2.5	4.5
PNG	1.8	2.3	3.0
Samoa	1.8	3.8	4.4
Timor-Leste	1.8	4.1	7.5
Tonga	8.4	6.4	5.0
Vanuatu	1.4	1.9	2.2

Fiscal Balance (% of GDP)

	2005	2006e	2007f
Fiji	-3.7	-4.0	-2.0
PNG	-0.6	2.5	-0.3
Samoa	0.3	-0.4	-1.0
Timor-Leste^	-17	-29	-34
Tonga	-1.3	-2.0	-2.5
Vanuatu	-1.9	-0.5	-0.7

Current Account Balance (% of GDP)

	2005	2006e	2007f
Fiji	-13.5	-21.3	-15.0
PNG	12.9	14.2	7.9
Samoa	-6.5	-7.2	-7.5
Timor-Leste~	42.2	48.5	50
Tonga*	-8.2	-10.5	-19.0
Vanuatu	-3.8	-6.1	-9.8

Foreign Exchange Reserves (US$ mn)

	2005	2006e	2007f
Fiji	284.8	230	260
PNG	718	1,400	1,850
Samoa	84.0	79.6	96.0
Timor-Leste	523	1,000	1,700
Tonga	44.0	44.9	50.0
Vanuatu	62.2	99.3	118.9

*: fiscal year beginning July +: non-oil GDP ^: non-oil fiscal balance as % of non-oil GDP ~: % of GNI

Long Term Foreign Currency Government Bond Ratings

Investment Grade

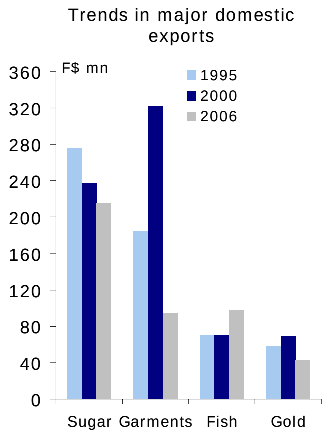
Moody's	S&P
Aaa Australia Canada France Germany Japan New Zealand Singapore United Kingdom United States	**AAA** Australia Canada France Germany Singapore United Kingdom United States
Aa1 Belgium	**AA+** Belgium New Zealand
Aa2 Hong Kong Italy Qatar Kuwait UAE	**AA** Hong Kong Japan
Aa3 Cayman Islands Macau Oman Taiwan	**AA-** Kuwait Qatar Taiwan Saudi Arabia
A1 China Cyprus Czech Republic Saudi Arabia	**A+** Italy
A2 Chile Hungary Israel Korea Poland	**A** Chile China Cyprus Korea Oman
A3 Malaysia	**A-** Czech Republic Poland Israel Malaysia
Baa1 Mexico South Africa Thailand	**BBB+** Bulgaria Hungary Thailand Russia South Africa
Baa2 Mauritius Tunisia Russia	**BBB** Mexico Tunisia
Baa3 Bulgaria India Romania	**BBB-** Romania India Colombia Morocco

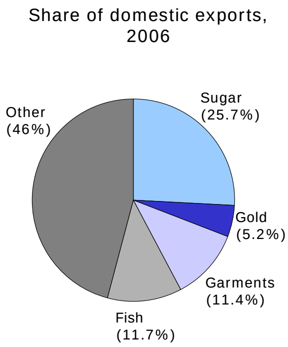
Sub-Investment Grade

Moody's	S&P
Ba1 Brazil Costa Rica Egypt Morocco Panama	**BB+** Egypt Peru Brazil Costa Rica
Ba2 Colombia **Fiji** Guatemala Jordan Peru	**BB** Jordan Panama Guatemala Vietnam
Ba3 Vietnam Turkey	**BB-** **Cook Islands** Indonesia Philippines Serbia Turkey Venezuela Ukraine Uruguay
B1 **Papua New Guinea** Philippines Suriname Ukraine Indonesia Pakistan Uruguay	**B+** Argentina Ghana Pakistan Cambodia **Papua New Guinea**
B2 Honduras Venezuela Cambodia	**B** **Fiji** Paraguay
B3 Argentina Bolivia Lebanon	**B-** Bolivia Lebanon
Caa1 and below Cuba Ecuador Nicaragua Paraguay	**CCC and below** Ecuador

Country Update: Fiji

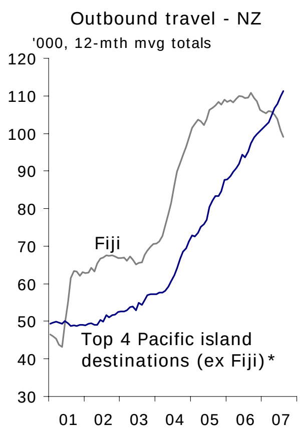
Fiji's major exports



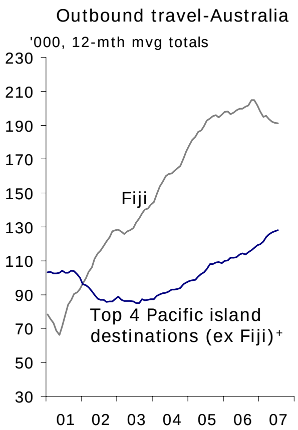


Sources: Fiji Islands Bureau of Statistics, Reserve Bank of Fiji

Main tourist-generating markets still show weakness



*: Cook Islands, Samoa, Tonga, Vanuatu



+: PNG, Vanuatu, Samoa, New Caledonia

Sources: Statistics New Zealand, ABS

- Interim PM Bainimarama has indicated that elections will be scheduled in early 2009. While this represents progress towards a return to a democratically-elected civilian government, constructive engagement with the international community has suffered a setback with the re-imposition of emergency regulations in September. Interim PM Bainimarama has, however, indicated that this would be a temporary measure.
- Fiji's main industries continue to under-perform and the current political climate has made the operating environment more challenging. Sugar and textiles & garments are Fiji's main exports, collectively accounting for 37% of domestic exports in 2006. Lower crop yields highlight the need for restructuring within the sugar industry, which could be delayed if EU funding is withheld, while the uncertainty surrounding land leases has undermined production. The textile & garments industry continues to be buffeted by competitive pressures. Garment export earnings were down 8.6% in annual terms for January-April 2007 compared with the same period in 2006.
- The re-opening of the Vatukoula gold mine, on the other hand, could generate increased employment and provide valuable foreign exchange earnings once gold exports resume. In addition, the bottled water market is proving to be a lucrative market for Fiji and the fisheries industry has performed well. Fish exports were up 7.5% YOY in the first four months of this year.
- Tourism earnings are likely to improve next year if travel advisories are not upgraded and the security situation stabilises. Ten months since the coup and international visitor arrivals have failed to recover as strongly as initially expected. According to official estimates, visitor arrivals for the first half of this year were down 5.1% against the same period in 2006 and the impact on tourist-related operators would be more severe given that a fair share of travellers classified their purpose of visit as "visiting friends and relatives". Fiji's two main tourist-generating markets, namely Australia and New Zealand are still recording declines in outbound travel to Fiji.
- Inflation continues to edge up as food shortages fuel price increases. Annual inflation in June 2007 climbed to 7.1% compared with 2.6% in January before easing to 6.4% in July. Price pressures are, however, expected to persist as imported food prices stay high due to supply constraints and oil prices remain elevated.

Jasmine Robinson

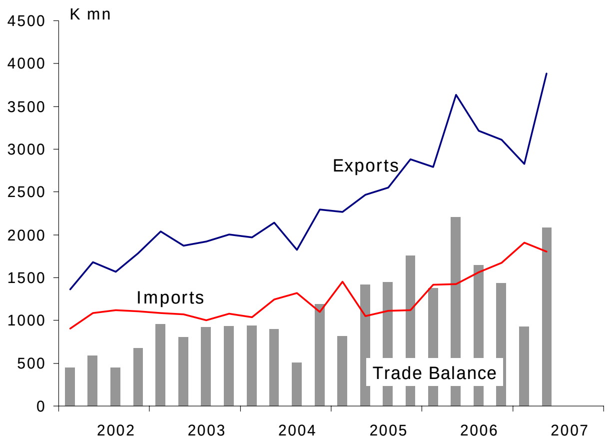
Economic data – Fiji

Quarterly data	Sep 05	Dec 05	Mar 06	Jun 06	Sep 06	Dec 06	Mar 07	Jun 07
Consumer Price Index, % YOY	2.3	2.2	2.1	1.6	2.5	3.7	3.6	6.4
Domestic Credit, % YOY	22.6	26.6	30.0	29.6	27.4	23.6	16.7	n/a
Exports, % YOY	-21.1	-29.4	-3.9	-31.2	6.5	5.3	8.8	n/a
Imports, % YOY	16.6	4.4	17.9	7.7	20.2	4.1	0.4	-3.2
Trade Balance, US$ mn	-271.6	-295.8	-280.9	-336.9	-347.5	-305.9	-272.8	n/a
Foreign Exchange Reserves, US$ mn	359.3	284.8	215.7	226.2	205.4	n/a	n/a	n/a

Sources: Datastream, Fiji Islands Bureau of Statistics, IMF

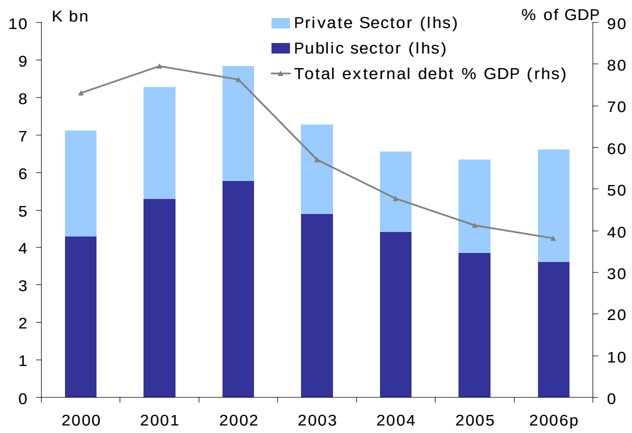
Country Update: Papua New Guinea

Strong merchandise trade position



Source: BPNG

External debt indicators improve



Source: BPNG

- PNG continues to post relatively healthy balance of payments surpluses, albeit smaller than in 2006. The current account surplus was K304 mn for the first half of 2007, down from K1.06 bn in H1 2006. This largely reflected a narrowing of the merchandise trade surplus and deterioration in the services deficit. For the first half of this year, the merchandise trade surplus was K3.1 bn, which was 12.7% lower, in kina terms, than the same period in 2006. While exports continued to perform well, rising by an annual rate of 7.1% in kina terms, imports rose a sharp 32%, largely reflecting stronger demand for capital goods in the mining sector. Increased payments for transport and insurance costs, and other business services led to the wider shortfall in the services account. Nevertheless, these developments reflect increased investment in the economy which is expected to help underpin medium-term growth prospects.
- The capital and financial account strengthened in the first half of 2007 compared with the corresponding period in 2006. It recorded a net inflow of K102 mn compared with a net outflow of K313 mn in 2006. Increased donor-funded project financing as well as investment in the mining sector fuelled inflows.
- The rapid accumulation of foreign exchange reserves over recent years, thanks to a healthier balance of payments, has led to an improvement in import cover which has risen from 4.2 months in 2002 to more than 8 months in 2006 according to official data. As at June 2007, reserves were K4.78 bn (US$1.6 bn), sufficient for 7.6 months of imports.
- PNG's external debt indicators have also improved. External debt (both public and private sector) was K6.6 bn in 2006. This was equivalent to 38.2% of GDP and 48.1% of exports of goods and services, down sharply from 79.5% of GDP and 115.8% of exports in 2001. The debt service ratio has also declined to a more manageable 11% in 2006 compared with 22.9% in 2001.
- With commodity prices expected to remain elevated over the next twelve months, economic growth prospects for PNG continue to be favourable. Together with improving external debt management and a relatively stable political backdrop, this leaves scope for further upgrades by credit rating agencies.

Jasmine Robinson

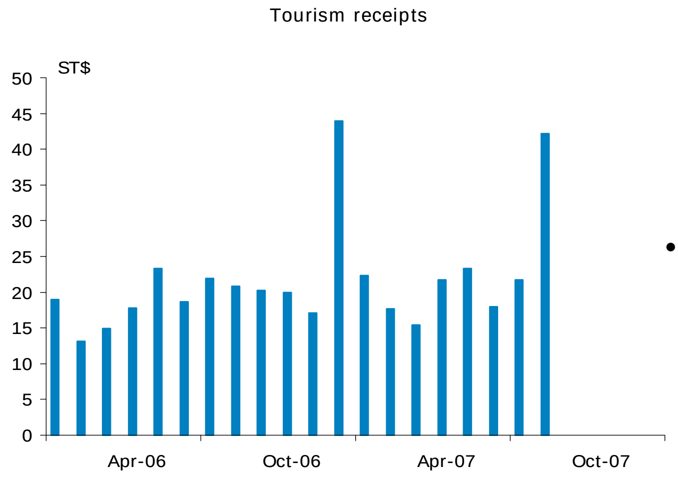
Economic data – Papua New Guinea

Quarterly data	Sep 05	Dec 05	Mar 06	Jun 06	Sep 06	Dec 06	Mar 07	Jun 07
Employment Index, % YOY	2.5	3.1	8.1	7.8	4.6	8.6	9.9	9.5
Consumer Price Index, % YOY	1.6	4.6	2.7	2.3	5.3	-1.0	1.0	1.0
- BPNG Trimmed mean, % QOQ	0.7	0.1	0.0	0.7	0.5	0.5	0.7	1.1
- NSO exclusion based, % QOQ	-0.1	-0.5	0.1	0.9	-1.5	5.3	1.3	1.4
Exports, % YOY	43.3	26.1	24.3	47.6	27.0	9.6	0.8	9.3
Imports, % YOY	-14	2.2	-1.5	36.3	42.3	51.7	33.7	29.3
Trade Balance, US$ mn	471.7	573.2	454.0	725.7	543.4	474.0	303.1	700.0
Foreign Exchange Reserves, US$ mn	641.2	717.5	708.6	960.1	1267.6	1400	1363.6	1545.4

Sources: Bank of Papua New Guinea, IMF

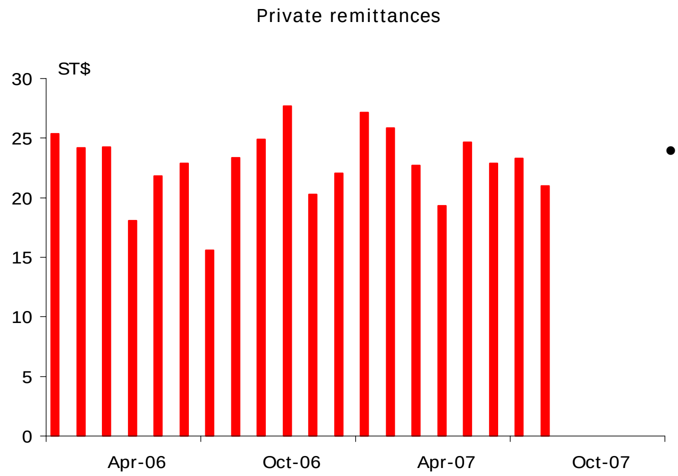
Country Update: Samoa

The South Pacific Games saw visitor arrivals soar



Source: Central Bank of Samoa

Private remittance flows have been easing lately



Source: Central Bank of Samoa

- The South Pacific Games (SPG) was held in Samoa from 25 August to 8 September. All 22 nations were represented and despite some concerns in the lead up, the quality of SPG facilities proved adequate and the games have provided a positive boost to Samoa's regional profile. Following the success of the games, Samoa's Prime Minister Ruila'epa Sailele Malielegaoi has announced plans to promote Samoa as Pacific's regional centre for sporting events, starting with the world weightlifting competition in November.
- The SPG has provided a significant boost to the local economy, through higher tourism as well as the building of sports facilities and the infrastructure upgrades. The latest Ministry of Finance statistics showed that Samoan GDP growth was a strong 4.6% YOY in the March quarter of 2007 with the construction sector expanding by 11.4% YOY. Meanwhile athletes and sports officials attending the SPG are estimated to have boosted tourist arrivals to 18,168 in August, a phenomenal increase of 88% MOM. These arrivals are expected to have led a 94% MOM surge in tourism revenue to ST$42.2 mn.
- Despite this recent strength, the Samoan economy is expected to slow in the coming year. The end of SPG-related building will weigh on the construction sector while a slowdown in the global economy may adversely impact remittances, merchandise exports and tourist arrivals. Indeed, lower export receipts saw Samoa's merchandise trade deficit widen slightly to ST$51.7 mn in August while remittances dropped by 10% YOY to ST$20.0mn last month.
- Nevertheless, a positive outlook for other sectors of the economy should help to soften this downturn. Infrastructure development is expected to remain supported following the World Bank's approval of a US$8.3 mn grant to fund road and bridge projects. The manufacturing sector should also see further benefits from the re-structuring and subsequent increase in productivity of a major local manufacturer. Samoa's relative political stability meanwhile should also see it continue to win tourist market share away from Fiji.
- Further ahead, the government's stated intention to change from left hand drive to right hand drive vehicles in July 2008 has the potential to disrupt activity. The government has stated that they believe Samoans will be able to import cheaper right hand drive vehicles from New Zealand and Australia. While this could deliver long-term benefits, in the short term there is the possibility that Samoa's external deficit could widen and that costs could increase to businesses affected by the transition.

Katie Dean

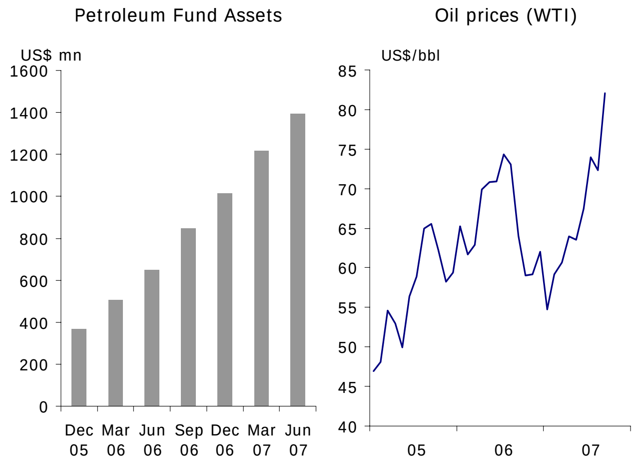
Economic data – Samoa

Quarterly data	Sep 05	Dec 05	Mar 06	Jun 06	Sep 06	Dec 06	Mar 07	Jun-07
Real GDP, % YOY	4.4	3.2	n/a	-1.8	4.1	6.3	4.7	n/a
Consumer Price Index, % YOY	1.1	4.1	4.5	3.3	3.1	4.3	5.1	6.5
Exports, % YOY	-21.4	-3.1	-25.9	-17.3	-27.0	34.0	16.0	20.2
Imports, % YOY	14.3	21.5	39.2	-3.9	25.0	72.0	37.0	16.5
Trade Balance, US$ mn	-43.0	-52.2	-46.5	-46.4	-53.8	-53.2	-45.8	-54.2
International Reserves, US$ mn	92.3	87.7	68.2	73.7	76.3	86.3	86.8	79.9

Sources: Bloomberg, Datastream, Samoa Ministry of Finance

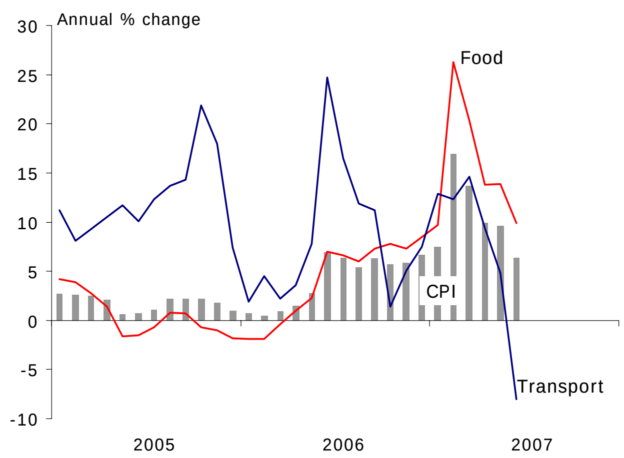
Country Update: Timor-Leste

Oil & gas revenues strengthen



Sources: ADB, Banking and Payments Authority; Datastream

Inflation recedes as supply is restored



Source: National Directorate of Statistics, Timor-Leste

- Former president and leader of the National Congress for Timorese Reconstruction (CNRT), Xanana Gusmao was sworn in as Prime Minster in August 2007, to lead a coalition government. Neither of the major political parties secured a majority in the June parliamentary elections. The Fretilin party won 21 of the 65 seats while the CNRT secured 18 seats but the latter formed an alliance with smaller parties to control parliament. PM Gusmao nominated Jose Guterres of Fretilin as his deputy.

- A sharp pick-up in real non-oil GDP growth is still expected for 2007 but the initial projections for a 30%-plus expansion have been trimmed to around 22% according to recent estimates from the Asian Development Bank. While the large peacekeeping force and public sector infrastructure spending will support growth in 2007 and 2008, disruption to activity from civil unrest is expected to undermine economic prospects. In addition, the need to manage policy differences within a coalition government could see a more measured approach towards economic reform and slower progress in developing the non-oil economy. The ADB has forecast non-oil GDP growth of 3.5% in 2008.

- Timor-Leste's oil & gas revenues continue to strengthen. The Petroleum Fund, in which oil & gas revenues are paid into and then invested abroad, increased to US$1.4 bn as at June 2007 compared with US$650 mn as at June 2006. This is also almost three times non-oil GDP. Under a long-term fiscal expenditure and savings policy, government sustainable spending is determined by the estimated permanent (interest) income from Petroleum Fund assets and domestic non-oil revenue. However, actual capital spending has fallen short of budgeted increases reflecting the need to make improvements in administrative capacity and monitoring. The need to push ahead with capital spending and develop the non-oil sector is particularly acute as socio-economic conditions remain poor and unemployment stays high, exacerbating law & order concerns.

- Inflation eased significantly in the second quarter as pressures on food supply and transport abated. Annual inflation moderated to 6.4% in June, reflecting a decline in transport costs as well as a return of food inflation to single digits after double-digit growth in the first half. Average inflation is forecast to reach 7.5% in 2007 and moderate to 3-4% in 2008 provided that the security situation remains calm, allowing for food production and distribution to be fully restored.

Jasmine Robinson

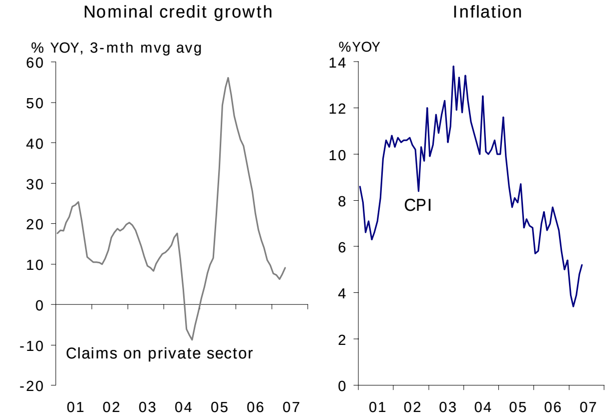
Economic data - Timor-Leste

Quarterly data	Sep 05	Dec 05	Mar 06	Jun 06	Sep 06	Dec 06	Mar 07	Jun 07
Consumer Price Index, % YOY	1.8	1.7	0.7	5.4	6.0	6.1	12.7	8.6
- Food, % YOY	0.3	-1.2	-1.4	5.3	6.6	7.9	18.8	12.5
- Transport, % YOY	13.4	15.8	2.9	16.3	13.2	4.6	13.3	2.1
Exports+, US$ mn	3.3	2.6	1.5*	0.2*	3.1*	3.2	n/a	n/a
Imports^, US$ mn	33	19.7	19.6*	10.5*	17.3*	33.3	n/a	n/a
Trade Balance, US$ mn	-29.7	-17.1	-18.1*	-10.3*	-14.2*	-30.1	n/a	n/a

+: comprising at least 50% local content by value; ^: excluding imports by foreign embassies and the UN *: data for two months
Sources: National Directorate of Statistics, Economist Intelligence Unit

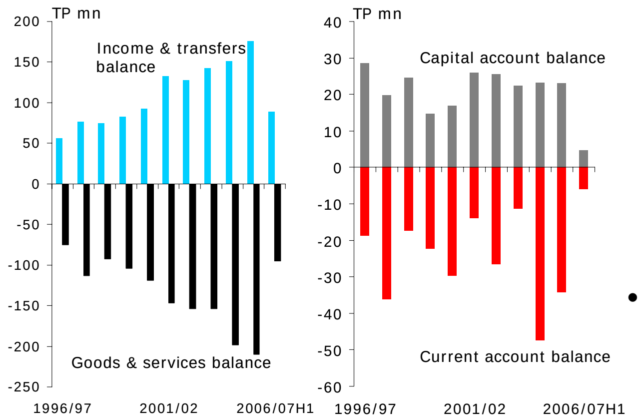
Country Update: Tonga

Inflation and credit growth



Sources: Datastream, IMF

Current Account stays weak



Sources: Datastream, IMF

- The Tongan economy is gradually recovering from the disruption to activity in the aftermath of the November 2006 riots. Credit growth is picking up as reconstruction and business investment gains momentum. Inbound travel is also expected to improve now that the situation has calmed down. Tonga plays host to the 38th Pacific Islands Forum in October 2007, providing a welcomed boost to the tourism sector. Real GDP is forecast to expand marginally by around 0.5% in FY2007/08 (fiscal year beginning July) after an estimated contraction of 3.5% in FY2006/07. Inflation has also moderated to an average annual rate of 4.2% for the first five months of this year compared with 6.5% in the same period in 2006.
- The latest available data on the balance of payments shows that the current account deficit for the first half of FY2006/07 (July-December 2006) narrowed to TP6 mn compared with TP8.6 mn for the corresponding period in FY2005/06. This is in spite of a reduction in remittance inflows over the same period. Remittances amounted to TP63 mn, down from TP67 mn in H1 FY2005/06. The outlook, however, is for further weakness in the current account as exports under-perform and imports, particularly of capital goods, pick up. Tonga's main exports are fish, squash, root crops and vanilla bean, which, in 2005 accounted for just 6% of total imports. Remittances are expected to remain substantial and provide a buffer to a weaker merchandise trade account. However, interest payments on foreign currency debt are likely to rise over the coming year as offshore borrowing increases. According to IMF estimates, the current account deficit for FY2006/07 was 10.5% of GDP and is forecast to widen to 19% of GDP in FY2007/08.
- Foreign exchange reserves edged up to US$50 mn as of June 2007, thanks largely to multilateral and bilateral financial assistance. This is equivalent to around 4 months of imports. We could, however, see some pressure on reserves in FY2007/08 given the forecast deterioration in the current account deficit. Funding for reconstruction is expected to see Tonga's external debt accelerate to 45.7% of GDP in FY2007/08 from an estimated 36.9% of GDP in the previous year according to the IMF. The debt service ratio is forecast to stay at around 10%.
- On the political front, a new parliamentary reform committee was formed in mid-2007 to submit recommendations for political reform. However, with elections due in March 2008, it will be difficult to see proposed policy changes being implemented prior to the elections.

Jasmine Robinson

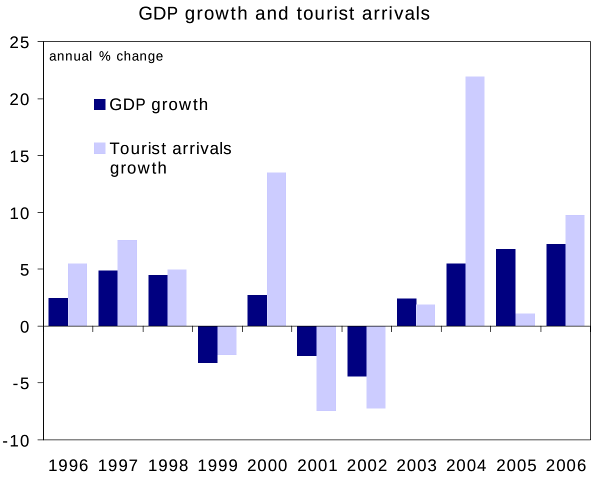
Economic data – Tonga

Quarterly data	Sep 05	Dec 05	Mar 06	Jun 06	Sep 06	Dec 06	Mar 07	Jun 07
Consumer Price Index, % YOY	7.8	7.0	6.1	7.1	7.2	5.4	3.7	n/a
Private Sector Credit, % YOY	55.9	39.8	35.0	23.2	15.0	11.1	7.8	n/a
Exports, % YOY	-39.8	-56.1	15.2	2.8	25.6	-3.6	-2.9	n/a
Imports, % YOY	16.2	-9.0	5.7	6.0	4.0	20.1	17.9	n/a
Trade Balance, US$ mn	-30.7	-26.1	-24.8	-29.7	-31.3	-33.6	-30	n/a
Foreign Exchange Reserves, US$ mn	46.2	44.0	39.2	43.2	45.1	44.9	47.0	50.1

Sources: Datastream, IMF

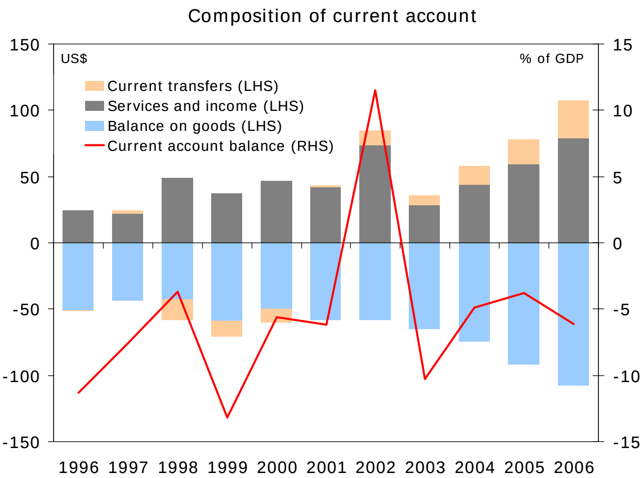
Country Update: Vanuatu

GDP growth driven by tourism



Source: Economics@ANZ, IMF

Current account deteriorates as trade deficit widens



Source: Economics@ANZ, ADB

- The latest official estimates show a 7.2% expansion of GDP in 2006, up from 6.8% in 2005. This strong result was driven by an acceleration of growth in the construction sector that reached 15.7% in the year. The real estate & business services and wholesale & retail sectors also both recorded impressive growth at 12.4% and 11.2% respectively. The disbursement of funds from the Millennium Challenge Corporation and significant increases in aid from New Zealand (20% increase in 07-08) and Australia (28% increase in 07-08) will provide the foundation for further economic expansion in coming years. We anticipate that economic growth will continue to be robust in 2007 at around 5½-6%.

- Pleasingly, the strong rate of economic growth in 2006 was not accompanied by a significant acceleration of inflation which averaged 1.9% for the year. However, inflation has ticked upwards to 2.8%YOY in the first quarter this year. This rise has been driven primarily by food and alcohol & tobacco sub-categories which increased by 3.2%YOY and 6.5%YOY respectively. The strength of the vatu, which moves closely with the AUD and NZD, should assist in keeping imported inflation in check especially with an increasing volume of imports coming from Asia.

- Strong domestic demand in recent years has fuelled consistent import growth which has led to a deterioration of the trade balance. According to ADB figures, Vanuatu's trade deficit came in at around US$110 mn in 2006. Despite strong tourism receipts and remittance inflows, this has led to a wider current account deficit of 6.1% of GDP in 2006, an increase from the 3.8% deficit recorded 2005. The trade deficit may take a further hit this year as Vanuatu's biggest trading partner, Australia, has banned the importation of kava due to its excessive use in indigenous communities causing social and health problems.

- Tourism continues to play a significant role in the expansion of the Vanuatu economy. In 2006, receipts from tourism accounted for 20% of GDP on the back of a record 68,179 tourist arrivals (up 9.7% from last year) and 85,922 day visitors (up 35.2% from last year). Growth in tourist numbers to June 2007 have also been very positive with arrivals expanding by 15.4%YOY and day visitors from cruise ships up 37.4%YOY.

- The Recognised Seasonal Employer program, in which around 1,000 workers from Vanuatu are temporarily employed in New Zealand's agriculture industry, continues this year. The program has provided a significant boost to incomes with each worker expected to be able to save around Vt700,000.

Alex Joiner

Economic data – Vanuatu

Quarterly data	Sep 05	Dec 05	Mar 06	Jun 06	Sep 06	Dec 06	Mar 07	Jun 07
Consumer Price Index, % YOY	0.6	1.8	1.9	2.2	1.8	1.7	2.8	n/a
Tourist Arrivals, ´000	-	-	13.8	15.1	19.8	19.5	16.5	18.8
Exports, % YOY	43.5	-44.6	50.4	-11.7	-23.7	43.6	10.4	n/a
Imports, % YOY	-9.1	34.0	-27.7	51.2	7.9	-26.7	72.2	n/a
Trade Balance, US$ mn	27.5	-29.8	10.9	-55.3	5.9	10.0	-18.8	n/a
Foreign Exchange Reserves, US$ mn	61.2	62.2	64.5	78.3	86.8	99.3	n/a	n/a

Sources: Vanuatu Statistics Office, Datastream, IMF DoTs

ANZ Research

Economics@ANZ

Saul Eslake
Chief Economist
+61 3 9273 6251
Saul.Eslake@anz.com

Fiona Allen
Business Manager
+61 3 9273 6224
Fiona.Allen@anz.com

Tony Pearson
Head of Australian Economics
+61 3 9273 5083
Tony.Pearson@anz.com

Mark Rodrigues
Senior Economist, Industry
+61 3 9273 6286
Mark.Rodrigues@anz.com

Wain Yuen
Economist, Industry
+61 3 9273 6295
Wain.Yuen@anz.com

Riki Polygenis
Senior Economist (Acting), Australia
+61 3 9273 4060
Riki.Polygenis@anz.com

Amber Rabinov
Economist, Australia
+61 3 9273 4853
Amber.Rabinov@anz.com

Amy Auster
Head of International Economics
+61 3 9273 5417
Amy.Auster@anz.com

Katie Dean
Senior Economist, International
+61 3 9273 1381
Katie.Dean@anz.com

Jasmine Robinson
Senior Economist, International
+61 3 9273 6289
Jasmine.Robinson@anz.com

Dr. Alex Joiner
Economist, International
+61 3 9273 6123
Alex.Joiner@anz.com

Paul Braddick
Head of Financial System Analysis
+61 3 9273 5987
Paul.Braddick@anz.com

Ange Montalti
Senior Economist, Financial System Analysis
+61 3 9273 6288
Ange.Montalti@anz.com

Warren Hogan
Head of Markets Research
+61 2 9227 1562
Warren.Hogan@anz.com

Cherelle Murphy
Senior Economist, Markets
+61 3 9273 1995
Cherelle.Murphy@anz.com

ANZ Investment Bank

Warren Hogan
Head of Markets Research
+61 2 9227 1562
Warren.Hogan@anz.com

Sally Auld
Senior Interest Rate Strategist
+61 2 9227 1809
Sally.Auld@anz.com

Tony Morriss
Senior Currency Strategist
+61 2 9226 6757
Anthony.Morriss@anz.com

Cherelle Murphy
Senior Economist, Markets
+61 3 9273 1995
Cherelle.Murphy@anz.com

Mark Pervan
Commodity Strategist
+61 3 9273 3716
Mark.Pervan@anz.com

David Croy
Strategist
+44 20 7378 2070
croyd@anz.com

Patricia Gacis
Market Strategist
+61 2 9227 1272
Patricia.Gacis@anz.com

Sarah Percy-Dove
Head of Credit Research
+61 2 9227 1142
Sarah.Percy-Dove@anz.com

Research & Information Services

Mary Yaxley
Head of Research & Information Services
+61 3 9273 6265
Mary.Yaxley@anz.com

Marilla Rough
Senior Information Officer
+61 3 9273 6263
Marilla.Rough@anz.com

Manesha Jayasuriya
Information Officer
+61 3 9273 4121
Manesha.Jayasuriya@anz.com

ANZ New Zealand

Cameron Bagrie
Chief Economist
+64 4 802 2212
bagriec@anz.com

Khoon Goh
Senior Economist
+64 4 802 2357
gohk@anz.com

Philip Borkin
Economist
+64 4 802 2199
borkinp@anz.com

Sean Comber
Economist
+64 4 802 2286
combers@anz.com

Steve Edwards
Economist
+64 4 802 2217
edwards1@anz.com

Kevin Wilson
Rural Economist
+64 4 802 2361
Kevin.Wilson@nbnz.co.nz

Important Notice

Australia and New Zealand Banking Group Limited is represented in:

AUSTRALIA by:

Australia and New Zealand Banking Group Limited ABN 11 005 357 522

10th 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

40 Bank Street, Canary Wharf, London, E14 5EJ, United Kingdom

Telephone +44 20 3229 2121 Fax +44 20 7378 2378

UNITED STATES OF AMERICA by:

ANZ Securities, Inc. (Member of NASD and SIPC)

6th 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 National Bank Limited

Level 7, 1-9 Victoria Street, Wellington, New Zealand

Telephone +64 4 802 2000