

# Monthly Economic Review

## December 2014

Tonga continues to benefit from global developments. Unemployment rates fell in the US and Australia by 0.2 percentage points to 5.6%, and 0.1 percentage points to 6.1% respectively. World oil price also dropped more than 40% over the year to approximately USD\$60 per barrel by December, benefitting importers of oil.

The domestic economy was positive over the month of December despite a decline in agricultural activities. Container registrations rose by 32.3% to its highest level on record, promoting growth in both the formal and informal parts of the distribution sector. In addition to declining fuel prices, the transport sector also benefited from a 25.4% increase in vehicle registrations over the month. A 66.7% rise in taxis and rentals registration (the highest in nine years) suggests growing business expectations for increased future consumption. The arrival of cruise ships and a 60.6% increase in international air arrivals over the month contributed to growth within the tourism sector, amounting to a 42.4% increase in travel receipts in real terms over December.

In contrast, agricultural production levels were low over the month due to unfavorable weather conditions slightly offsetting the strong growth in the other sectors. Sales volumes within the domestic agricultural market declined by 9.6% over the month. In value terms, the decline was only 0.8% due to price increases from low supply. Export volumes also declined, attributable to the end of the squash season in November. However, it remained 30.7% higher compared to December 2013, which should contribute to year ended growth.

Headline inflation eased over the month by 0.5% despite increases in Food prices. The rise in Food prices over December was due to a combination of low domestic food supply due to the recent drought and increased imported food prices due to the strengthening New Zealand dollar. The drop in headline inflation was mainly due to falling global oil prices leading to lower prices for the Household Operation and the Transportation.

In year ended terms, inflation was 0.2% as a result of rising prices of Food, Clothing & Footwear, and Miscellaneous goods & services. Domestic power & fuel prices fell in line with contracting global oil prices. Prices for Domestic Fruits & vegetables increased by 7.2% over the year reflecting limited local supply. Meanwhile, Imported Meats, fish & poultry prices increased contributing to the overall rise of 1.3% in Imported prices.

Both the Nominal Effective Exchange Rate (NEER) and the Real Effective Exchange Rate (REER) fell over the month by 0.4% and 1.0%, respectively. In year-ended terms they fell at a faster rate of 1.4% and 3.4% respectively.

Tonga's overall Overseas Exchange Transactions balance was a \$25.8 million surplus over December compared to a deficit of \$3.6 million in November. The overall surplus was a result of a significant increase in net inflows in both the current and capital account. The receipt of government budget support contributed to the increase in the current account while interbank transfers with overseas branches resulted in higher net inflow in the capital account. Although the value of imports fell



by 9.2% over the month due to falling oil prices, exports receipts increased by 73.5% due to exports of agricultural and marine products. Travel receipts rose over the month due to the additional flights to Tonga in December with remittances picking up by 25.7%. Consequently foreign reserves rose to its highest level of \$293.6 million over the month, sufficient to cover 9.9 months of imports.

Broad Money rose by 2.6% (T\$10.0 million) over December due to an increase in net foreign assets more than offsetting a fall in net domestic assets. The rise in net foreign assets reflect an increase in foreign reserves, whereas the decline in net domestic assets reflects a slowdown in lending. The rise in currency in circulation and total domestic demand deposits support the increase in broad money.

Banking system liquidity rose by 6.5% (T\$9.4 million) to T\$153.7 million over the month. In year ended terms, the increase was 15.4%. This is the highest annual percentage growth since June 2013.

Bank lending fell over the month mainly due to a decline in lending to businesses within the construction and agricultural sectors. In year ended terms, credit growth was 7.5% compared to a 6.6% growth in December 2013. Credit growth including loans extended by non-banks was only 5.6%, reflecting the unwinding of the on-lending for the construction of Central District Buildings in Nuku'alofa.

Weighted average interest rate spread widened over the month to 6.7% by 5 basis points due to weighted deposit rates falling more than the decline in weighted lending rates.

At the end of December 2014, the stock of government bonds in circulation totaled

around \$30 million, of which more than 60% are held by the commercial banks. These bonds were issued at terms ranging from 5 to 7 years, carrying an interest rate ranging from 3 to 6 percent. The next bond issue of \$5 million will be in February 2015 at 3.3% for a term of 2 years.

The government's net credit position with the banking system improved by over \$15 million during the month to above \$60 million compared to a decrease of \$4 million during the previous month. The improvement in the government's net credit position was largely due to a significant increase in its deposits with the banking system. This stemmed from an increase in government's revenue and budget support received during the month and the receipt of funds for projects from donors.

The NRBT maintains its positive outlook on domestic growth with increasing tourism and declining oil prices, fostering growth in transport, distribution and other sectors within the economy. Whilst agricultural production levels are low, exports remain higher than those recorded in the previous year. Inflation has been maintained within acceptable levels as global oil prices continue to fall. Foreign reserves are comfortably above the expected levels due to increased exports, travel receipts, remittances and budget support. Whilst bank lending decreased, bank liquidity recorded its highest annual percentage growth since June 2013. The government's net credit position has also improved. The existing monetary policy setting is therefore considered appropriate. The NRBT will continue to closely monitor the country's economic developments and financial conditions to adjust the monetary policy stance for macroeconomic stability and economic growth.

