



## MONTHLY ECONOMIC REVIEW

Vol. 3

No. 11

Month Ended: November 2016

International developments amongst Tonga's main trading partners indicated varied performances. The U.S.<sup>1</sup> recorded an upward revision of GDP growth for the third quarter from 2.9% to 3.2%. This reflected upward revisions to consumer spending and housing investment. In addition, the U.S. recorded their lowest unemployment rate since August 2007 of 4.6% in November, declining from 4.9% in October. A slight rise in Australia's unemployment rate to 5.7% in November was recorded from 5.6% the previous month. Furthermore, the Reserve Bank of Australia (RBA) decided to leave the cash rate unchanged at 1.50% as inflation is expected to remain low. The Reserve Bank of New Zealand (RBNZ) eased their monetary policy settings by cutting the Official Cash Rate (OCR) by 25 basis points to 1.75%. This is to support economic growth that is strong enough to have inflation, currently at 0.4%, settle near the middle of the RBNZ's inflation target range of 1-3%.

Indicators of local economic activities were mixed in November 2016 but overall, broadly positive. The closing of the squash season contributed largely to a fall in agricultural export volumes by 2,686.0 tonnes (80.7%). Increases in business loans for construction and individual housing loans continue to support the economic activities in the secondary sector. The performance in the services sector varied over the month. The container registrations rose by 286 containers (35.5%) in November 2016 led by rises in both business and private container registrations. This reflects expectation of an increase in consumption in preparation for the Christmas holidays. On the other hand, vehicle registrations declined in November by 20 vehicles (5.8%). The financial sector remained strong during the month and continued to record higher credit growth.

The total number of job advertisements over November fell by 1 vacancy however rose over the year by 84 vacancies led by recruitment intentions in all the sectors. This indicates a rising demand for labour in Tonga and may assist in reducing the unemployment rate.

Prices	Monthly		Annual	
	Nov-16	Oct-16	Nov-16	Oct-16
Headline Inflation (%)	NA	-0.5	6.6	6.1
Domestic prices	NA	-1.8	NA	7.0
Imported prices	NA	0.5	NA	5.5

The November 2016 Inflation report is yet to be published by the Statistics Department. However, the annual headline inflation rate for October 2016 recorded a 6.1% increase, which is slightly lower than the NRBT's forecast of a 6.7% increase. The continued shortage of kava-Tonga and new custom duty and excise tax driving the higher prices over the year. Monthly inflation on the other hand fell underpinned from a lower prices in domestic fruits & vegetables namely watermelon, pineapple and peanuts. This reflected the harvesting season for these food items. Higher prices of petrol in October drove the 0.5% rise in imported prices. NRBT anticipates the annual headline inflation to be around 6.6% in November 2016.

	Monthly			Annual	
	Nov-16	Oct-16	% Growth	Nov-15	% Growth
Nominal Effective Exchange Rate	91.4	90.8	0.7	94.4	-3.2
Real Effective Exchange Rate	100.8	100.2	0.6	99.2	1.7

In November, the United States Dollar (USD), New Zealand Dollar (NZD) and the British Pound (GBP) strengthened against the Tongan Pa'anga (TOP) while the Australian Dollar (AUD), Fijian Dollar (FJD) and Japanese Yen (JPY) weakened against the TOP, which contributed to the slight increase in the Nominal Effective Exchange Rate (NEER) over the month. Over the year, the NEER fell by 3.2%. The Real Effective Exchange Rate (REER<sup>2</sup>) also rose over the month by 0.6% and over the year by 1.7%, which may impact Tonga's international competitiveness.

	Monthly			Annual	
	Nov-16	Oct-16	% Growth	Nov-16	% Growth
OET Receipts (TOP \$ million)	51.8	61.3	-15.5	694.4	19.1
Export receipt	3.0	2.3	30.4	19.3	27.4
Travel receipts	7.6	8.1	-6.6	89.8	13.4
Private transfers	20.3	21.2	-4.4	240.7	19.1
OET Payments (TOP \$ million)	51.5	52.2	-1.5	604.9	13.8
Import payments	27.9	28.5	-1.9	341.2	10.9
Services payments	11.1	10.5	6.0	133.8	23.5
Primary Income payments	1.3	6.5	-80.0	24.3	41.8

Overseas Exchange Transaction (OET) payments for November was slightly lower than it was last month. This was mostly a result of lower payments of primary income particularly on dividend payments compared to payments made last month. The rise in OET payments over the year ended November 2016 was driven by import payments, mainly wholesale, retail and construction imports.

OET receipts also fell in November, largely driven by lower receipts of government grants compared to the

<sup>1</sup> Source: U.S. Bureau of Economic Analysis

<sup>2</sup> REER based on the NRBT's forecasted inflation rate.



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previous month. Export receipts however, rose largely owing to the inflow of proceeds from squash and marine exports. On year ended terms, OET receipts rose driven by higher remittances and services receipts.

	Monthly			Annual	
	Nov-16	Oct-16	% Growth	Nov-15	% Growth
Foreign Reserves (\$ in million)	360.9	367.0	-1.7	319.0	13.1
Import Coverage (months)	9.1	9.3		8.9	

The overall balance for November 2016 which is the net change to foreign reserves was a deficit of \$6.1 million. This brought the official foreign reserves to \$360.9 million by the end of November, equivalent to 9.1 months of imports cover, which is well above the NRBT's minimum range of 3-4 months<sup>3</sup>.

Money	Monthly			Annual	
	Nov-16	Oct-16	% Growth	Nov-15	% Growth
Money Supply (\$ in million)	493.6	501.2	-1.5	427.8	15.4
Net Foreign Asset	366.8	375.0	-2.2	305.0	20.3
Net Domestic Asset	126.9	126.4	0.4	123.1	3.1

Broad money decreased over November 2016. This was largely contributed by the fall in foreign reserves which was partly offset by the increase in private sector domestic credit. The liquidity (reserve money)<sup>4</sup> in the banking system decreased over the month due to cash withdrawal from the vault to facilitate the preparation for the festive season. Broad money rose over the year due mainly to a marked increase in net foreign asset. The receipt of the government budget support funds during the year explains the higher foreign reserves and corresponds to the increase in net foreign assets.

Lending	Monthly			Annual	
	Nov-16	Oct-16	% Growth	Nov-15	% Growth
Total Lending (\$ in million)	377.5	368.2	2.5	324.0	16.5
Business lending	166.8	163.1	2.3	155.2	7.5
Household lending	209.4	203.8	2.8	167.5	25.1

Total bank lending rose in November 2016. Lending to households increased to a new high record of \$209.4 million, driven mainly by growth in housing loans. This reflects higher borrower capacity and demand for housing by individuals, which also lends support for higher lending to the construction, tourism and mining & quarrying sectors. The increasing activity in the construction and tourism sectors was partially supported by low interest rates from the Government Development Loans scheme. Annual credit growth as at the end of November 2016 was

\$53.4 million (16.5%) higher than the \$35.0 million (12.0%) annual credit growth in November 2015. This is expected to continue increasing in the near term.

Interest Rates	Monthly			Annual	
	Nov-16	Oct-16	Growth (bps)	Nov-15	Growth (bps)
Weighted Average Banks Deposit Rate (%)	2.261	2.252	1.0	2.176	8.5
Weighted Average Banks Lending Rate (%)	7.907	7.893	1.4	8.069	-16.1
Weighted Average Interest Rate Spread (%)	5.646	5.641	0.5	5.893	-24.7

Higher interest rates over the month on business and housing loans contributed to an increase in the weighted average lending rate to 7.91%. In addition, the weighted average deposit rate rose to 2.26% due mainly to higher interest rates offered on demand deposits. Consequently, the weighted average interest rate spread slightly widened over the month by 0.5 basis points to 5.65% in November 2016. Over the year, the weighted average interest rate spread narrowed by 24.7 basis points mainly due to a lower weighted average lending rate and an increase in the weighted average deposit rate. Total loans to deposit ratio rose slightly to 76.6% in November 2016 from 74.1% last month, still below the 80% minimum loan to deposit ratio target which indicates excess liquidity in the banking system remains.

Net credit to government fell over the month and over the year by \$4.2 million and \$24.5 million respectively driven by a rise in government deposits. This reflects higher government revenue collection during the month, including the receipt of dividends and higher custom duty and excise tax collected which is also in line with the increase in the number of container registrations during the month.

The NRBT's outlook for strong domestic economic activity remains in the near term. The level of foreign reserves is also expected to remain comfortable supported by expected higher receipts of remittances and foreign aid, despite the projected rise in imports. Upward inflationary pressure remains in the near term due to amendments made to custom duty and excise tax effective on 1<sup>st</sup> July 2016. The banking system remains sound. NRBT will continue to closely monitor and review its monetary policy setting to maintain internal and external monetary stability, and to promote a sound and efficient financial system to support macroeconomic stability and economic growth.

<sup>3</sup> IMF projects the level of foreign reserves for 2016/17 to be equivalent to 5.7 months of goods and services imports.

<sup>4</sup> Liquidity in the banking system (reserve money) is a sum of currency in circulation, exchange settlement account balances, and required reserve deposits.