



## MONTHLY ECONOMIC REVIEW

Vol. 4

No. 12

Month Ended: December 2017

Global movements largely indicated favourable growth over the month. The US economy recorded an annual GDP growth of 2.6% for the final quarter of the year, due to strong consumption and significant growth in imports. Improving economic growth for Australia was reported however, concerns surround consumption spending. This stems from slow wage growth and high debt levels. New Zealand's annual GDP growth expanded in the September 2017 quarter by 2.4%. This resulted mainly from high construction activity offsetting declines in dairy production. Overall, Tonga's major trading partners project positive growth ahead.

The performance of all sectors of the domestic economy was favorable except for the agricultural sector recording lower export volume. The on-going construction activities continued to boost the performance of the secondary sector, which coincided with a 2.3% and 4.2% growth in individual housing loans and loans for business construction respectively. The tertiary sector improved over the month. Total lending rose by \$16.4 million (3.9%). Total air arrivals increased by 64.9%, as people travelled for vacation and to spend Christmas with their respective families. The rise in total international arrivals is in line with a \$3.1 million rise in travel receipts. In addition, total number of container registrations increased by 249 (24.8%), as both private and business containers rose by 40.0% and 11.4% respectively. Similar to previous years, total vehicle registrations rose by 142 during the month, due to higher light and heavy vehicles and cars registered. Electricity production slightly increased by 4.8% and 62 more customers were recorded during the month. Agricultural exports on the other hand declined by 56% largely due to the end of the squash season.

As a partial indicator of employment, 23 job advertisements were reported for December 2017, similar to the previous month but fell over the year by 93 vacancies. According to the Statistics Department's 2016 Census Population and Housing report, the unemployment rate for Tonga is 16.4%.

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Dec-17	Nov-17	Dec-17	Nov-17
<b>Headline Inflation (%)</b>	<b>0.8</b>	<b>-1.0</b>	<b>5.5</b>	<b>5.0</b>
Domestic prices	1.4	-0.8	3.0	1.8
Imported prices	0.4	-1.1	7.4	7.4

Source: Statistics Department

After five months of consistent deflation, monthly inflation rose by 0.8% in December due to higher prices of local

food and imported petroleum. Local inflation rose by 1.4% over the month due to the seasonality of fruits, vegetables, and seafood. Imported inflation increased by 0.4% as the prices for petrol, diesel, kerosene, LPG, and tobacco increased in December.

Over the year to December 2017, headline inflation rose further to 5.5% compared to 5.0% in November 2017, but lower compared to 6.7% recorded in December 2016. Imported prices contributed 4.3 percentage points to the overall headline inflation. This was due to higher prices of imported food, tobacco, and petroleum prices. These included imported commodities such as fruits & vegetables, lamb flaps, chicken pieces, flour, winfield blue cigarettes, petrol and diesel. The local component of inflation contributed 1.2 percentage points to the overall headline inflation which was attributed to the rise in prices of electricity, kava-Tonga, house maintenance services, and the seasonality of local food.

Table 2: Exchange Rates

	Monthly			Annual	
	Dec-17	Nov-17	% Growth	Dec-16	% Growth
Nominal Effective Exchange Rate Index	91.3	91.5	-0.3	92.0	-0.8
Real Effective Exchange Rate Index	103.1	102.9	0.2	101.0	2.1

Sources: NRB T

In December, the Tongan Pa'anga depreciated against the AUD and NZD, leading to a fall in the Nominal Effective Exchange Rate (NEER) index. The AUD strengthened due to firmer commodity prices, particularly iron ore, and improvement in the unemployment rate. The NZD was supported by the release of strong growth data for the September quarter. On the other hand, Real Effective Exchange Rate (REER) index slightly rose over the month and year which reflected Tonga's higher headline inflation rate relative to its trading partners, which may impact the international competitiveness of the Tongan exports of goods and services.

Table 3: Overseas Exchange Transactions

	Monthly			Annual		
	Dec-17	Nov-17	% Growth	Dec-17	Dec-16	% Growth
<b>OET Receipts (TOP \$ million)</b>	<b>67.2</b>	<b>55.1</b>	<b>22.0</b>	<b>744.8</b>	<b>727.7</b>	<b>2.3</b>
Export receipt	1.1	2.9	-62.5	21.9	21.0	4.3
Travel receipts	9.9	6.8	44.9	112.8	95.6	17.9
Private transfers	26.8	23.0	16.4	275.8	246.7	11.8
Others	29.5	22.4	31.5	334.3	364.4	-8.3
<b>OET Payments (TOP \$ million)</b>	<b>62.8</b>	<b>52.8</b>	<b>19.0</b>	<b>678.9</b>	<b>610.8</b>	<b>11.2</b>
Import payments	37.0	26.5	39.6	388.3	345.0	12.6
Services payments	15.5	12.9	20.1	147.2	136.9	7.5
Primary Income payments	0.4	1.1	-60.3	35.1	24.2	44.9
Others	9.9	12.3	-19.4	108.3	104.7	3.5

Source: Banking System

Total Overseas Exchange Transaction (OET) receipts rose by 22.0% to \$67.2 million in December 2017. This was mainly due to higher receipts for private capital investment, particularly grants received by non-profit organizations. In year ended terms, total receipts rose by



## MONTHLY ECONOMIC REVIEW

Vol. 4

No. 12

Month Ended: December 2017

2.3% due to higher inflow of remittances. Total OET payments also rose over the month by 19.0% to \$62.8 million, due mainly to higher import payments particularly for wholesale and retail trade imports. Similarly, total payments for the year ended December rose by 11.2% to \$678.9 million, driven by higher payments for wholesale and retail trade imports. The overall OET balance for December 2017 recorded a deficit of \$2.3 million. This contributed to the decline in the official foreign reserves to \$422.5 million, equivalent to 7.8 months<sup>1</sup> of import cover, which is above the Reserve Bank's minimum range of 3-4 months.

Table 4: Foreign Reserves

	Monthly			Annual	
	Dec-17	Nov-17	% Growth	Dec-16	% Growth
Foreign Reserves (\$ in million)	422.5	424.8	-0.5	378.8	11.5
Import Coverage (months)	7.8	7.9		7.1	

Sources: NRBT

Broad money (money supply) increased over December due to a rise in net domestic assets, mainly net domestic credit to the non-financial public sector, outweighing a decline in net foreign assets reflecting the decrease in foreign reserves over the month. Annually, broad money increased due to a significant rise in net foreign assets (foreign reserves) outweighing the fall in net domestic assets (net domestic credit).

Table 5: Money Supply

	Monthly			Annual	
	Dec-17	Nov-17	% Growth	Dec-16	% Growth
Money Supply (\$ in million)	560.6	553.5	1.3	512.2	9.5
Net Foreign Asset	441.8	444.2	-0.6	390.5	13.1
Net Domestic Asset	119.0	109.6	8.6	121.8	-2.3

Source: Banking System, NRBT

Liquidity in the banking system (reserve money) fell over December to \$295.9 million. This was largely driven by a decline in deposits by the commercial banks to the Reserve Bank vault and was partially offset by an increase in currency in circulation. This could be attributed to the higher spending by individuals and businesses during the busy festive season. The banks' total loans to deposit ratio increased considerably to 76.4% in December from 73.7% last month. This reflected a \$16.4 million (3.9%) increase in total lending outweighing the rise in total deposits of \$1.4 million (0.2%). This continued to remain below the minimum loan to deposit ratio of 80% indicating excess liquidity in the banking system remains and that there is capacity for further lending by banks.

<sup>1</sup> Method of calculation changed in February 2017 to include both imports of goods & services (previous method used imports of goods only)

Table 6: Total Lending

Lending	Monthly			Annual	
	Dec-17	Nov-17	% Growth	Dec-16	% Growth
Total Lending (\$ in million)	436.7	420.3	3.9	381.6	14.5
Business lending	192.7	180.8	6.6	167.8	14.8
Household lending	243.1	238.6	1.9	212.5	14.4
Other lending	1.0	0.9	6.6	1.3	-21.0

Source: Banking System, NRBT

Total banks' lending rose significantly over December to \$436.7 million. This was a result of higher business loans to the public enterprises, wholesale & retail, and services sectors. Lending to households continued to be driven by higher housing loans, and supported by growth in personal and vehicle loans. Over the year, total banks' lending increased owing to a significant rise in individual housing loans. This reflected higher borrower capacity and demand for housing by individuals. Business lending also increased driven by higher loans to the wholesale & retail, services, and transport sectors. Low interest rates from the Government Development Loans partially supported the higher lending in the manufacturing and fisheries sectors. Furthermore, this continued to coincide with strong domestic economic activities evident throughout the year.

The weighted average interest rate spread narrowed over December. The decline stemmed from a decrease in the weighted average lending rate and an increase in the weighted average deposit rate. The weighted average lending rate fell due mainly to lower lending rates for businesses specifically for the agriculture, utilities, and construction sectors. The weighted average deposit rate rose due to higher demand deposit rates. Annually, the weighted average interest rate spread narrowed as the higher deposit rates was partially offset by an increase in lending rates. However, the loans interest rates remained favourable as lending to households and businesses maintained its growth momentum over the year.

Table 7: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Dec-17	Nov-17	Growth (bps)	Dec-16	Growth (bps)
Weighted Average Banks Deposit Rate (%)	2.160	2.159	0.1	2.082	7.8
Weighted Average Banks Lending Rate (%)	7.944	7.967	-2.4	7.907	3.7
Weighted Average Interest Rate Spread (%)	5.784	5.809	-2.5	5.824	-4.1

Source: Banking System, NRBT

Net credit to Government continued to decline over the month by \$4.0 million, driven by a rise in government deposits supported by the receipts of grants and project funds during the month. Similarly, net credit to Government fell over the year by \$45.9 million due to receipts of budgetary support and government grant



## MONTHLY ECONOMIC REVIEW

Vol. 4

No. 12

Month Ended: December 2017

funds, as well as improved government revenue collection.

The Reserve Bank in its August 2017 Monetary Policy Statement expected a strong real GDP growth of 4.0% in 2017/18, higher than the 3.4% growth projected by the IMF Article IV mission in September 2017. The level of foreign reserves is also expected to remain at comfortable levels supported by expected higher receipts of remittances and foreign aid. This will be partially offset by the projected rise in imports. Upward inflationary pressure remains in the near term, however it is expected to fall below the Reserve Bank's inflation reference rate

of 5% per annum in 2017/18. In light of the above developments and that the banking system remained sound, the Reserve Bank Board maintained its current monetary policy measures. The Reserve Bank will remain vigilant and continue to closely monitor developments in the domestic and global economy for early signs of vulnerability or overheating of the economy. Furthermore, the Reserve Bank will continue to update its monetary policy setting to maintain internal and external monetary stability and to promote a sound and efficient financial system, in order to support macroeconomic stability and economic growth.