



## MONTHLY ECONOMIC REVIEW

Vol. 4

No. 1

Month Ended: January 2017

The IMF in its January 2017 update on World Economic Outlook has indicated a stronger global growth projection of 3.4% in 2017 compared to a growth of 3.1% in 2016, supported by growth in the advanced economies. U.S. inflation rose by 2.5% in January 2017, notably the biggest increase in nearly four years due to higher household prices particularly for gasoline and other goods. This compared to a 2.1% rise in the previous month. The U.S. unemployment rate rose to 4.8% in January from 4.7% in the previous month despite an expanding labor market as more jobs were created. In contrast, Australia recorded a lower unemployment rate at 5.7% down compared with 5.8% in December as a surge in part-time jobs offset a slump in full-time work. Australia's trade surplus narrowed significantly by almost two-thirds due mainly to lower consumer goods exports. New Zealand's merchandise trade deficit widened by NZD\$249 million in January 2017 largely due to higher oil imports.

Domestically, the economic activities somewhat slowed in January 2017, comparing to December 2016. This trend is similar to previous years. The winding down of economic activity was due to seasonality in the agricultural products as well as the end of the festive and Christmas holiday season. From the primary sector, the agricultural export volume continued to fall over the month of January by 63.2% to 208.4 tonnes, due to the decrease in exports of all major agricultural products, mostly root crops. Furthermore, according to the NRBT liaison program with growers in the domestic agricultural market, the supply of root crops and vegetables slightly declined over the month due to seasonality. The vegetable production is currently in low season which usually starts in November to March of every year due to climate condition. However, it was noted that the favorable watermelon season towards the end of last year, lasted to January 2017.

The activities in the secondary and tertiary sectors recorded mixed growth over the month. Container registrations dropped significantly in January by 612 registrations (60.5%), driven by a decrease in both business and private container registrations which indicated a slowdown in the wholesale and retail activities. Furthermore, vehicle registrations declined by 133 registrations (31.8%). International air arrivals fell over the month by 34.3% however the arrival of two cruise ships over the month may have supported the tourism sector. A total of 21 cruise ships are expected to arrive in the year 2017, which is expected to support growth in the

tourism industry during the year. However, the on-going activities in the construction and manufacturing sectors continued to lift performance in the secondary sector, supported by an increase in individual housing loans of 2.7% and business lending to manufacturing companies of 3.7%.

The total number of job advertisements increased by 3 vacancies over January 2017 and also rose over the year by 11 vacancies, led by recruitment intentions in all the sectors except for the services sector. This indicates a rising demand for labour in Tonga and may assist in reducing the unemployment rate.

Prices	Monthly		Annual	
	Jan-17	Dec-16	Jan-17	Dec-16
Headline Inflation (%)	0.6	0.3	5.4	6.7
Domestic prices	1.3	0.1	2.4	6.4
Imported prices	0.2	0.3	7.7	6.9

Seasonality in local produce drove a 0.6% increase in the inflation rate over the month. Domestic prices increased by 1.3% driven by a 7.4% rise in prices for local fruits and vegetables reflecting the short supply of vegetables during the month. In addition, prices of various items of the imported food category increased, followed by an increase in the electricity and imported tobacco prices.

The annual inflation rate rose by 5.4% in January 2017. This was mainly due to a 7.7% increase in imported prices. This continued to reflect the amended custom duties and excise taxes on various food products and tobacco that became effective in July 2016. The price of imported meat, fish and poultry rose by 18.3%, followed by a rise of 16.6% and 9.4% in the price of imported tobacco and fuel respectively. The prices of other food components such as cereals and cereal products and sugar also increased over the year. The prices of household supplies and services increased by 5.4% over the year whilst the price of house maintenance goods rose by 2.7%. Moreover, the domestic annual inflation rate rose by 2.4% with the price of kava-Tonga remaining the highest contributor with a 167.8% rise over the year due to its continued short supply.

	Monthly			Annual	
	Jan-17	Dec-16	% Growth	Jan-16	% Growth
Nominal Effective Exchange Rate Index	91.0	91.5	-0.6	93.5	-2.7
Real Effective Exchange Rate Index	101.1	101.2	-0.1	100.1	0.9

In January 2017, the Australian Dollar (AUD), New Zealand Dollar (NZD) and Fijian Dollar (FJD) appreciated against the Tongan Pa'anga (TOP) while the United States Dollar (USD), Chinese Yuan (CNY), Japanese



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Yen (JPY), Euro Dollar (EUR) and British Pound (GBP) depreciated against the TOP. As a result, both the Nominal Effective Exchange Rate (NEER) index and the Real Effective Exchange Rate (REER) index slightly decreased over the month. In annual terms, the NEER index continued to fall while the REER index rose. The rise in the REER index reflects 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.

	Monthly			Annual	
	Jan-17	Dec-16	% Growth	Jan-17	% Growth
<b>OET Receipts (TOP \$ million)</b>	<b>57.5</b>	<b>92.3</b>	<b>-37.7</b>	<b>745.8</b>	<b>29.7</b>
Export receipt	2.2	3.9	-42.6	22.2	48.5
Travel receipts	10.0	12.8	-21.9	99.1	23.7
Private transfers	20.4	28.7	-29.2	250.6	19.2
Others	24.9	46.8	-46.9	373.8	38.7
<b>OET Payments (TOP \$ million)</b>	<b>42.8</b>	<b>51.2</b>	<b>-16.4</b>	<b>610.8</b>	<b>13.9</b>
Import payments	26.0	30.9	-15.8	344.1	10.7
Services payments	10.0	12.2	-18.1	139.3	27.3
Primary Income payments	0.6	0.9	-32.3	24.2	49.0
Others	6.2	7.2	-13.9	103.1	3.4

Total OET receipts for the month of January 2017 was \$57.5 million, a significant decrease of 37.7% from December 2016. This was mainly driven by lower official receipts following a peak last month from inflows of government grants for ongoing development projects. Private transfer receipts which are mostly remittances also declined as expected. However, in annual terms, total OET receipts rose by 29.7% which was largely attributed to higher private remittances and official grant receipts. Majority of the remittance receipts were in USD which coincided with the depreciation of the Tongan Pa'anga against the USD. The AUD and NZD followed which was supported by the weakening of the Tongan pa'anga against these currencies. This is consistent with the continuous rise in the outbound travel from these countries over the year.

Total OET payments declined in January 2017, similar to last month, by 16.4% due to lower imports and services payments. Lower imports payments were underpinned by a decrease in the payments for wholesale & retail goods. In annual terms, total OET payments however rose by 13.9%, which was attributed to higher imports and services payments, particularly payments for oil and freight payments.

The overall balance of OET for January 2017 was a

	Monthly			Annual	
	Jan-17	Dec-16	% Growth	Jan-16	% Growth
Foreign Reserves (\$ in million)	380.8	378.8	0.5	326.3	16.7
Import Coverage (months)	10.4	10.4		8.9	

surplus of \$2.1 million. This contributed to the increase in the official foreign reserves to \$380.8 million in January 2017, equivalent to 10.4 months of imports cover, which is well above the NRBT's minimum range of 3-4 months.<sup>1</sup>

Despite the higher foreign reserves contributing to the higher net foreign assets over the month, the 13.7% decline in net domestic assets resulted in a slight decline in broad money (money supply) over January. The decrease in other items (net) drove the lower domestic assets.

Money	Monthly			Annual	
	Jan-17	Dec-16	% Growth	Jan-16	% Growth
Money Supply (\$ in million)	512.0	512.2	-0.03	447.5	14.4
Net Foreign Asset	407.1	390.5	4.3	324.9	25.3
Net Domestic Asset	105.1	121.8	-13.7	122.9	-14.5

Over the year, broad money increased driven mainly by the increase in foreign reserves. The liquidity (reserve money)<sup>2</sup> in the banking system decreased over January 2017 due mainly to lower currency in circulation possibly due to the end of the festive season. This was due mainly to higher cash deposits from commercial banks to the NRBT vault during the month. Banks' total loans to deposit ratio continued to fall in January 2017 to 72.4% from 74.1% in the previous month. This remained below the 80% minimum loan to deposit ratio target which indicates excess liquidity in the banking system remains. Despite the strong growth in the banks' loan books, this was outweighed by the continuous growth in deposits, which coincides with the higher foreign reserves. This indicates more capacity remains for further lending by the banks.

Lending	Monthly			Annual	
	Jan-17	Dec-16	% Growth	Jan-16	% Growth
Total Lending (\$ in million)	382.2	381.6	0.2	328.9	16.2
Business lending	166.3	167.8	-0.9	155.5	6.9
Household lending	214.8	212.5	1.1	172.0	24.9

Banks' lending rose over the month as well as over the year mainly as a result of increased lending to households. Specifically, housing and vehicle loans drove the monthly and annual movement further reflecting high borrower capacity and demand by individuals. Lending to businesses fell over January yet rose over the year. The

<sup>1</sup> Calculation is based on imports of goods only from the past 12 months

<sup>2</sup> Sum of currency in circulation, exchange settlement account balances, and required reserve deposits.



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decrease in lending to the agricultural and trade sectors led the monthly decline for business loans possibly due to business activities in these sectors winding down from the busy festive season. However, on an annual basis, the increase in lending to the tourism, agricultural, construction and manufacturing sectors contributed largely to the higher lending to businesses. The lower interest rates from the Government Development Loans partially supported the higher lending to these sectors. Credit growth was \$53.4 million (16.2%) over the year to January, which exceeded the \$36.3 million (12.4%) growth in the year ended January 2016.

The weighted average interest rate spread narrowed in January 2017 to 5.70% due to the weighted average lending rate rising which outweighed the increase in the weighted average deposit rate. Household lending rates for vehicles and other personal lending rates increased over the month. Business lending rates particularly for the manufacturing and construction sectors also increased over the month. The weighted average deposit rate rose as a result of higher demand and savings deposit rates.

Interest Rates	Monthly			Annual	
	Jan-17	Dec-16	Growth (bps)	Jan-16	Growth (bps)
Weighted Average Banks Deposit Rate (%)	2.177	2.129	4.8	2.187	-1.0
Weighted Average Banks Lending Rate (%)	7.881	7.869	1.2	8.039	-15.7
Weighted Average Interest Rate Spread (%)	5.704	5.740	-3.6	5.852	-14.7

Over the year, the weighted average lending rate and the weighted average deposit rate declined. Both lower lending rates to businesses and households contributed to driving down the weighted average lending rate. Specifically, housing lending rates dropped along with lower lending rates for the agricultural, utilities and

tourism sectors. This also coincided with higher credit growth noted over the year. Meanwhile, lower savings and term deposit rates resulted in the decrease in the weighted average deposit rate. Overall, the weighted average interest rate spread narrowed by 14.7 basis points.

A continued increase in government deposits over the month and over the year led to a decline in net credit to government by \$6.4 million and \$44.5 million respectively. The rise in government deposits reflected the receipt of project grants from development partners. The receipt of government grants in January outweighed the outflows reported in the banking system (OET).

Despite the slowdown in January, the NRBT's outlook for strong domestic economic activity remains in the medium 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 1st July 2016 but expected to be well below the NRBT's inflation reference rate of 5% per annum in 2017/18. The banking system remained sound. The NRBT will continue to closely monitor developments in the domestic and global economy, and 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.