



MONTHLY ECONOMIC REVIEW

Vol. 4

No. 7

Month Ended: July 2017

According to the International Monetary Fund's (IMF) World Economic Outlook Update released in July 2017, global growth remains on track with global output projected to grow by 3.5% this year. This remains unchanged from the IMF's WEO release earlier this year in April. The US experienced a stronger labour market with unemployment rate falling to 4.3% from 4.4% last month. However, downward revision of US projected growth from 2.3% in 2017 to 2.1% is due to the expectation of less expansionary fiscal policy than previously forecasted. Australia reported annual GDP growth of 1.7% for the June 2017 quarter which is lower than last year's GDP growth of 2.5%. The slowdown was due to downturn in building activities and moderating mining investments. However, partial indicators have been positive such as exports and strong population growth. New Zealand experienced stable developments with the momentum for growth reported to pick up. This is mainly in terms of improving tourism industry and solid household economic growth supporting strong consumption activity.

Activities in the domestic economy were mixed in July. From the primary sector, the total volume of agricultural exports decreased by 189.4 tonnes (25.2%) due to a decline in almost all exported commodities. However, according to liaison with stakeholders in the domestic agricultural market, July was relatively more favourable compared to June and growth in lending to the agricultural sector continued to support growth in the sector. The secondary sector continued to show positive activities. Individual housing loans and business construction loans increased over the month by \$2.0 million (1.2%) and \$0.1 million (1.3%) respectively, which supported the construction sector. In the tertiary sector, international air arrivals declined by 3.0% followed by vehicle registrations decreasing by 21 vehicles (7.0%). Container registrations, on the other hand, increased by 12.3% as a result of higher number business container registrations which rose by 297 containers reflecting a vibrant trade sector during the month and spillover effects to the transportation sector.

Based on data collected by the Reserve Bank, the total number of job advertisements fell over July 2017 by 15 vacancies (60%). This was due mainly to lower advertisements for the services sector. Over the year to July, the number of vacancies advertised decreased by 63 vacancies (18.8%). However, the outlook for strong growth in the domestic economy is expected to support a lower unemployment rate.

Headline inflation declined over the month by 0.2% largely attributed to a 2.4% decrease in domestic prices. This was driven by increased supply of fruits and vegetables which drove its prices lower by 9.4%, followed by a 5.4% fall in electricity prices. Imported prices however increased by 1.5%. The revised customs duty and excise taxes that became effective in July 2017 contributed to a further rise in the price of tobacco. Imported food prices rose by 2.3% due mainly to a 3.8% increase in price of meat, fish and poultry. The price of chicken pieces increased by 4.1% and mutton flaps prices rose by 3.5% to an average price of \$4.07 and \$14.58 per kilogram respectively. Additionally, the price of Winfield blue rose by 12.9% to an average of \$18.73 per packet of 25 cigarettes.

Prices	Monthly		Annual	
	Jul-17	Jun-17	Jul-17	Jun-17
Headline Inflation (%)	-0.2	0.8	7.1	10.3
Domestic prices	-2.4	1.0	6.7	8.7
Imported prices	1.5	0.7	7.4	11.7

Source: Statistics Department

The annual headline inflation slowed to 7.1% in July 2017 from a high of 10.3% in the previous month, the highest level since September 2013. The decline over the month largely reflected the wind down of the hike in prices last year when the new excise tax became effective in July 2016. Imported prices rose by 7.4% over the year contributing 4.2 percentage points to the annual headline inflation, declining from a 11.7% rise in the previous month. The higher imported prices was due mainly to higher prices of imported food and tobacco. Meat, fish & poultry prices rose by 12.5% mainly driven by an 18.7% and 1.8% rise in the price of mutton flaps and chicken pieces respectively. The price of Winfield blue rose by 24.2%. Additionally, higher world oil prices drove the price of fuel higher by 6.0%, and petrol and diesel prices rose by 6.5% and 5.7% respectively. Furthermore, the price of kerosene and liquid petroleum gas increased by 14.4%.

Domestic inflation rose by 6.7% over the year to July 2017 contributing 2.9 percentage points to the headline inflation. This was driven by the seasonality of local food, short supply of kava-Tonga and electricity prices. The price of local food rose by 8.5% contributing 1.7 percentage points to the overall headline inflation due mainly to unfavourable weather in 2017 for growing vegetables compared to the same period in 2016. In addition, kava-Tonga and electricity prices rose annually by 43.0% and 12.6% respectively.



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	Monthly			Annual	
	Jul-17	Jun-17	% Growth	Jul-16	% Growth
Nominal Effective Exchange Rate Index	90.8	90.8	0.1	90.5	0.3
Real Effective Exchange Rate Index	105.2	105.5	-0.3	99.6	5.6

Sources: NRBT

In July 2017, the United States Dollar (USD) and New Zealand Dollar (NZD) appreciated against the Tongan Pa'anga (TOP) while the Australian Dollar (AUD), Chinese Yuan (CNY), Japanese Yen (JPY), British Pound (GBP), Euro (EUR) and Fijian Dollar (FJD) depreciated against the TOP. As a result, the Nominal Effective Exchange Rate (NEER) index slightly rose while the Real Effective Exchange Rate (REER) index slightly declined over the month. In annual terms, both the NEER index and the REER index rose. The rise in the REER index 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.

	Monthly			Annual	
	Jul-17	Jun-17	% Growth	Jul-17	% Growth
OET Receipts (TOP \$ million)	62.2	86.1	-27.8	753.7	13.7
Export receipt	1.1	1.7	-31.9	23.7	47.8
Travel receipts	11.4	11.3	1.5	110.7	32.3
Private transfers	23.8	24.5	-2.8	267.3	15.4
Others	25.8	48.7	-47.0	352.0	6.2
OET Payments (TOP \$ million)	60.9	67.3	-9.6	645.6	10.8
Import payments	32.9	39.7	-17.2	368.8	11.1
Services payments	11.1	11.9	-7.1	140.1	11.2
Primary Income payments	2.5	8.7	-71.5	35.5	109.8
Others	14.4	7.0	105.0	101.2	-6.0

Source: Banking System

Total Overseas Exchange Transaction (OET) receipts declined over the month of July 2017, by 27.8% to \$62.2 million. This was mainly driven by lower official transfer receipts following a peak in June from inflows of government budgetary support and grants. In year ended terms, total OET receipts continued to rise by 13.7% to \$753.7 million which was largely owing to the higher inflows of private remittance and travel receipts. The celebrations and annual events during the year supported the annual growth in remittances.

Total OET payments slightly declined over the month of July 2017 by 9.6% to \$60.9 million mainly due to lower import and primary income payments. Lower import payments were mainly due to less government and individual import payments, whereas the decline in primary income payments was mainly due to lower dividend repatriation to overseas shareholders. In annual terms, total OET payments however rose by 10.8%,

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

which was attributed to higher import and primary income payments, particularly payments for wholesale & retail goods and dividend repatriation to overseas shareholders.

	Monthly			Annual	
	Jul-17	Jun-17	% Growth	Jul-16	% Growth
Foreign Reserves (\$ in million)	408.9	407.9	0.2	367.4	11.3
Import Coverage (months)	7.4	7.4		7.4	

Sources: NRBT

The overall OET balance for July 2017 was therefore a surplus of \$1.1 million. This contributed to the rise in the official foreign reserves to \$408.9 million in July 2017, equivalent to 7.4 months¹ of imports cover, which is above the Reserve Bank's minimum range of 3-4 months.

Broad money (money supply) fell over the month of July. This was due to a fall in both net foreign and net domestic assets. Net foreign assets declined as a result of a decrease in the foreign currency accounts of commercial banks. This coincided with higher import payments made over the month of July. Meanwhile, net domestic assets fell driven by a rise in government deposits. Over the year, broad money rose significantly mainly as a result of an increase in net foreign assets. Underpinning this growth was the rise in the foreign reserves over the year. Net domestic assets also rose as net domestic credit increased over the year.

Money	Monthly			Annual	
	Jul-17	Jun-17	% Growth	Jul-16	% Growth
Money Supply (\$ in million)	533.2	534.9	-0.3	478.0	11.5
Net Foreign Asset	426.5	427.3	-0.2	374.3	13.9
Net Domestic Asset	106.9	107.7	-0.7	103.9	3.0

Source: Banking System, NRBT

Liquidity in the banking system (reserve money)² continued to fall over July to \$278.4 million. This largely reflected the issuing of the new notes to the banks during the King's birthday and other events in July which is also in line with the Reserve Bank's initiative to improve the quality of the notes in circulation. The banks' total loans to deposit ratio increased slightly from 75.4% last month to 76.3% in July reflecting the 0.6% growth in total loans outweighing the 0.5% decline in total deposits. Nevertheless, this ratio continued to remain below the 80% loan to deposit ratio minimum target which indicates excess liquidity in the banking system remains.

Total banks' lending increased over July and over the year to \$407.1 million. This remained driven by growth in

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



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lending to both households and businesses. Growth in household loans was attributed to higher lending for housing purposes. Meanwhile, the growth in business loans were due to an increase in lending to mainly the transport, manufacturing, and agriculture sectors over July. Over the year, household loans rose driven largely by housing loans whilst vehicle loans also contributed to the yearly household credit growth. Business loans increased as a result of the higher loans to the wholesale & retail, services, manufacturing and agricultural sectors. This coincided and supported other evident increases in domestic economic activities throughout the year. Additionally, the lower interest rates from the Government Development Loans have also supported the higher lending to these sectors. Credit growth over the year to July of \$55.2 million (15.7%) was higher compared to an annual credit growth in June of \$52.2 million (14.8%).

Lending	Monthly			Annual	
	Jul-17	Jun-17	% Growth	Jul-16	% Growth
Total Lending (\$ in million)	407.1	404.5	0.6	351.9	15.7
Business lending	176.0	175.0	0.6	161.2	9.2
Household lending	229.9	228.2	0.7	189.5	21.3
Other lending	1.2	1.2	-4.0	1.2	0.1

Source: Banking System, NRBT

The weighted average interest rate spread narrowed slightly in July to 5.654% from 5.686% in the previous month. This resulted from a widening weighted average deposit rate outweighing the increase in the weighted average lending rate. The increase in the weighted average lending rate over July was driven by higher lending rates for the fisheries, construction, and entertainment and catering sectors, as well as higher vehicle and housing lending rates. The decrease in the weighted average interest rate spread over the year was due to a decrease in the weighted average lending rate outweighing a decrease in the weighted average deposit rate. All deposit rates declined over the year with term deposit rates falling the most. This coincided with the significant increase in deposits over the year. Lending

rates fell as a result of lower rates for housing loans and vehicle loans declined as well as lower rates for almost all business loans specifically loans to the manufacturing, fisheries, and trade sectors. This supported the strong growth in lending to households and businesses over the month of July and over the year.

Interest Rates	Monthly			Annual	
	Jul-17	Jun-17	Growth (bps)	Jul-16	Growth (bps)
Weighted Average Banks Deposit Rate (%)	2.190	2.148	4.2	2.213	-2.3
Weighted Average Banks Lending Rate (%)	7.844	7.834	1.0	7.913	-6.9
Weighted Average Interest Rate Spread (%)	5.654	5.686	-3.2	5.700	-4.6

Source: Banking System, NRBT

Net credit to Government continued to fall over the month by \$4.3 million and over the year by \$51.4 million. This was mainly due to a rise in government deposits supported by receipts of government grant funds, as well as improved government revenue collection.

The Reserve Bank's outlook for strong domestic economic activity remains in the medium term. The level of foreign reserves is also expected to remain at comfortable levels supported by expected higher receipts of remittances and foreign aid and this will be partially offset by the projected rise in imports. Upward inflationary pressure remains in the near term due to the impact of the increase in custom duty and excise tax effective on 1st July 2016 and 2017; 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 early signs of vulnerability and 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.