



NATIONAL RESERVE BANK OF TONGA

MONTHLY ECONOMIC REVIEW

Vol. 4

No. 3

Month Ended: March 2017

World economic activities continued to indicate that positive growth is to continue throughout 2017. Tonga's major trading partners maintained their accommodative monetary policy stance over March except for the US. Whilst the Reserve Bank of Australia (RBA) and the Reserve Bank of New Zealand (RBNZ) kept rates unchanged, the Federal Reserve raised the federal funds rate by a quarter point to a range of 0.75 – 1% as the market had expected. This stemmed from steady economic growth in the US, an improving labour market, and greater confidence amongst businesses and consumers. Meanwhile, employment growth and robust trade activity continued to back economic growth all three countries.

Domestically, economic activities were mixed during the month. Primary sector activities varied, the total volume of agricultural exports continued to rise by 175.7 tonnes (42.5%). This was attributed to the increase in the export of root crops which rose by 136.5 tonnes (41.5%). Yam and cassava crops drove the increase reflecting the harvesting season of late yams. Contrastingly, total marine exports decreased by 77.1 metric tons (32.4%) largely due to a fall in the export of tuna and almost all aquarium products. Activities in the secondary sector reflected consistent strong growth as construction works continued to grow. This is in line with the increase in the number of electricity consumers by 76 new customers.

The tertiary sector indicated slow growth. This was reflected in a slight decline in the total number of container registrations by 21 containers (2.4%) over the month. Lower registrations of private containers outweighed a rise in business container registrations. This indicated an active trade sector particularly for the wholesale and retail distribution businesses. International air arrivals declined by 3.7% yet the arrival of two cruise ships during the month may have supported the tourism sector. One of the cruise ships, the Queen Victoria brought in over 1800 passengers and 900 crew members from French Polynesia.

The total number of job advertisements declined by 17 vacancies over March 2017 and also fell over the year by 23 vacancies, led by lower recruitment intentions in the services sector. However, the positive outlook for the economy supports the expectation for increased demand for labour in the near term and thereby lower unemployment rate.

Headline inflation increased over the month by 0.4% mainly driven by the rise in the prices of local and

imported food. Domestic inflation rose by 0.1% at the end of March due mainly to the seasonality of local food. Imported prices increased by 0.6% due to increased prices of food, tobacco, fuel, kerosene, and liquid petroleum gas.

Prices	Monthly		Annual	
	Mar-17	Feb-17	Mar-17	Feb-17
Headline Inflation (%)	0.4	3.7	9.4	8.9
Domestic prices	0.1	6.3	4.9	6.8
Imported prices	0.6	1.8	13.2	10.5

Despite the relatively low increase over the month, annual headline inflation rose by 9.4%. Due to the very low level of imported prices in March 2016, at negative 6.3%, the relatively small rise in the imported inflation rate of 0.6% has arithmetically resulted in a high annual imported inflation rate of 13.2%, in March 2017. This rise in imported prices by 13.2% contributed 7.2 percentage points to the annual headline inflation. All imported food categories rose, led by a 24.0% increase in prices of meat, fish & poultry followed by the prices of other food components such as sugar and flour rising by 14.6%. The prices of these imported food continued to reflect the excise taxes and custom duties imposed on various imported food in July 2016. This tax effect is also reflected in the 33.0% increase in price of Winfield blue tobacco. Additionally, the increase in world oil prices drove the price of fuel higher by 26.1%, followed by an increase in the prices of kerosene and liquid petroleum gas. The prices of household supplies and services and house maintenance goods for items such as paint and bricks also increased. Similarly, the domestic annual inflation rate rose by 4.9% largely due to the rise in electricity price, continued short supply of kava-Tonga, and volatile local food prices. The price of electricity rose by 17.8% contributing 0.8 percentage points to the annual headline inflation. The price of kava-Tonga increased over the year by 63.1%, followed by a 2.4% increase in the prices of local food, and a 5.4% increase in the price of domestic alcohol.

	Monthly			Annual	
	Mar-17	Feb-17	% Growth	Mar-16	% Growth
Nominal Effective Exchange Rate Index	91.4	91.2	0.2	91.8	-0.4
Real Effective Exchange Rate Index	105.3	104.8	0.5	98.3	7.1

In March 2017, the United States Dollar (USD), Australian Dollar (AUD) and Fijian Dollar (FJD) appreciated against the Tongan Pa'anga (TOP), while the New Zealand Dollar (NZD), Chinese Yuan (CNY), Japanese Yen (JPY), Euro Dollar (EUR) and British Pound (GBP) depreciated against the TOP. As a result,



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both the Nominal Effective Exchange Rate (NEER) index and the Real Effective Exchange Rate (REER) index slightly increased over the month. In annual terms, the NEER index continued to fall while 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	
	Mar-17	Feb-17	% Growth	Mar-17	% Growth
OET Receipts (TOP \$ million)	49.4	44.8	10.5	740.6	23.4
Export receipt	1.6	1.5	6.2	22.4	47.6
Travel receipts	7.1	6.0	17.0	102.4	27.3
Private transfers	21.2	17.5	20.7	254.7	17.0
Others	19.6	19.6	-0.3	361.2	25.9
OET Payments (TOP \$ million)	59.0	45.9	28.7	620.2	15.2
Import payments	37.2	21.0	76.5	355.4	16.1
Services payments	11.9	13.5	-11.5	145.9	30.0
Primary Income payments	1.5	0.5	200.9	21.9	36.0
Others	8.4	10.8	-22.2	97.0	-6.4

Total OET receipts rose over the month of March 2017, by 10.5% to \$49.4 million. This was mainly driven by the rise in private transfer for family support. Travel receipts also rose mainly due to higher personal travel receipts. On year ended terms, total OET receipts rose by 23.4% which was largely owing to the higher inflows of private remittances and official grant receipts. The celebrations and annual events during the year supported the annual growth in remittances. Majority of the annual remittance receipts were in USD and AUD which was supported by the depreciation of the TOP against these currencies. This coincided with the positive economic growth in these countries.

Total OET payments increased over the month of March 2017 by 28.7% to \$59.0 million due mainly to higher import payments. Primary income and transfer payments also increased largely reflecting higher external debt service payments during the month. Higher payments for oil and wholesale & retail goods drove the rise in imports. This was in line with the rise in vehicle registrations and the preparation by majority of private businesses for the peak season which begins in the coming months. Total OET payments also rose over the year by 15.2%, which was mainly driven by higher payments for services and primary income.

The overall OET balance for March 2017 was a deficit of \$11.6 million. This contributed to the decline in the official foreign reserves to \$366.0 million in March 2017,

equivalent to 6.7 months¹ of imports cover, which is still above the Reserve Bank's minimum range of 3-4 months.

	Monthly			Annual	
	Mar-17	Feb-17	% Growth	Mar-16	% Growth
Foreign Reserves (\$ in million)	366.0	377.7	-3.1	317.3	15.3
Import Coverage (months)	6.7	7.1		6.7	

Broad money (money supply) declined yet again over the month. This resulted from similar movements in the previous month where the decline in foreign reserves drove the decrease in net foreign assets. This had offset the rise in net domestic credit and was in line with the decrease in deposits over the month. Despite the monthly fall in broad money, it rose over the year largely led by the higher foreign reserves and the corresponding rise in net foreign assets.

Money	Monthly			Annual	
	Mar-17	Feb-17	% Growth	Mar-16	% Growth
Money Supply (\$ in million)	503.6	510.2	-1.3	451.6	11.5
Net Foreign Asset	389.7	402.2	-3.1	316.3	23.2
Net Domestic Asset	114.1	109.8	3.9	135.6	-15.9

Liquidity (reserve money)² in the banking system continued to decrease by \$8.8 million (3.2%) over March. This stemmed mainly from lower cash deposits by the commercial banks to the Reserve Bank vault throughout March as well as purchase of foreign exchange from the Reserve Bank for the higher import payments. The lower deposits led to an increase in the banks' total loans to deposit ratio to 75.5% from 73.3% in February. The loans to deposit ratio of banks remained below the 80% minimum loan to deposit ratio target which indicates excess liquidity in the banking system remains and that there is capacity for further lending by the banks.

Lending	Monthly			Annual	
	Mar-17	Feb-17	% Growth	Mar-16	% Growth
Total Lending (\$ in million)	391.2	384.5	1.7	338.7	15.5
Business lending	168.7	165.5	2.0	159.4	5.9
Household lending	221.3	217.9	1.6	178.0	24.3
Other lending	1.2	1.1	3.2	1.2	-5.6

Total banks' lending continued to rise over March as well as over the year to a new record high of \$391.2 million. Both the monthly and annual movements resulted from higher lending to households and businesses. Lending to households remained the significant contributor to the overall growth, particularly

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

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



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housing loans. Business loans also increased over the month led by increased loans to the trade, construction, and agricultural sectors. Over the year, housing loans continued to drive the increase in lending to household. This coincided with the \$14.2 million rise in import payments for construction materials. Growth in business loans over the year resulted mainly from more lending to the agricultural, trade, construction, and manufacturing sectors. The increase in business loans to these sectors over the year has supported domestic economic activities. The lower interest rates from the Government Development Loans partially supported the higher lending to these sectors. Credit growth over the year to March was similar to the growth over the year to February, recording a \$52.5 million (15.5%) increase.

Interest Rates	Monthly			Annual	
	Mar-17	Feb-17	Growth (bps)	Mar-16	Growth (bps)
Weighted Average Banks Deposit Rate (%)	2.251	2.213	3.8	2.201	4.9
Weighted Average Banks Lending Rate (%)	7.909	7.913	-0.4	7.944	-3.5
Weighted Average Interest Rate Spread (%)	5.659	5.700	-4.1	5.743	-8.4

The weighted average interest rate spread narrowed to 5.659% in March. This was due to a rise in the weighted average deposit rate while weighted average lending rate declined. Business lending rates fell over the month, mainly for the manufacturing, entertainment and catering, and transport sectors. On the other hand, the weighted average deposit rate increased driven by higher saving deposit rates. Over the year to March, the weighted average interest rate spread also narrowed by 8.4 basis points. Lending rates for businesses and households both fell over the month and the year and may have supported the higher credit growth recorded over the month of March and over the year.

Net credit to Government continued to rise over the month by \$3.0 million, due to a decline in government deposits. This reflected the external debt service payments made during the month. Over the year, net credit to government however fell driven by an increase in government deposits. The receipts of the budgetary support and grant funds during the year supported the higher deposits.

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, 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 accommodative monetary policy measures. The Reserve Bank 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.