



Tonga's major trading partners experienced varying levels of growth throughout February. The US financial markets recorded a slump in the stock markets which was driven by a change in the investors' risk appetite and temporarily affecting developments in the US economy. This followed the Federal Reserve's statement on accelerating economic growth and rise in wages as well as inflation indicating further rises in interest rates. New Zealand and Australia reported in their respective February 2018 Monetary Policy Statement (MPS) that GDP growth continues to remain relatively stable backed by business investments and strong labour market conditions. On the horizon, the outlook remains positive but the major trading partners are subject to downside risks such as financial stress and rising geo-political tensions.

Domestic economic activities in February 2018 were affected due to the devastation by Tropical Cyclone (TC) Gita, which would also be reflected in the economic activities of upcoming months. However, partial economic indicators were mixed over the month. The total agricultural exports declined by 210.7 tonnes mainly driven by a decrease in exported volume of root crops such as cassava and giant taro. Additionally, exported marine products (excluding aquarium products) rose by 10.4 tonnes as more tuna was exported during the month. Activities in the secondary sector remained positive. Individual housing and business construction loans increased whilst business manufacturing loans declined. In the tertiary sector, total loans slightly rose by 0.5% over the month. Nonetheless, container registrations decreased by 184 containers as both business and private containers declined by 14.0% and 39.1% respectively. Vehicle registrations also fell by 204 registrations, due mainly to lower registrations for cars and other light vehicles. This was followed by a 38.8% decline in air arrivals.

As a partial indicator of employment, the total number of job advertisements increased in February 2018 by 35 vacancies, mainly Public Administrations vacancies. However, over the year total vacancies decreased by 82 vacancies.

The official inflation rate for February 2018 is yet to be released by the Statistics Department. However, inflationary pressure is expected to remain in the near term partially due to the impact of TC Gita on the domestic food supply. The rise in fruit and vegetable prices is expected to push up domestic inflation. Over the year, the headline inflation is anticipated to be around 5.0% compared to 6.0% last month. The anticipated annual headline inflation is due to higher expectations in the prices of food, transportation, alcohol and kava-Tonga.

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

In February 2018, the Tongan Pa'anga depreciated against the USD, leading to a fall in the Nominal Effective Exchange Rate (NEER) index. The USD strengthened on upbeat US economic and inflation assessment and prospect for more stimulative US fiscal policy to increase investment over the next two years. On the other hand, the 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 1: Exchange Rates

	Monthly			Annual	
	Feb-18	Jan-18	% Growth	Feb-17	% Growth
Nominal Effective Exchange Rate Index	90.3	90.6	-0.3	91.7	-1.5
Real Effective Exchange Rate Index	105.1	103.1	2.0	104.1	0.9

Sources: NRBT

The overall Overseas Exchange Transaction (OET) balance for February 2018, was a surplus of \$23.9 million, the highest record since June 2016, corresponding to a rise in the official foreign reserves to \$448.0 million. This is equivalent to 8.1 months¹ of import cover, which is above the Reserve Bank's minimum range of 3-4 months.

Table 2: Foreign Reserves

	Monthly			Annual	
	Feb-18	Jan-18	% Growth	Feb-17	% Growth
Foreign Reserves (\$ in million)	448.0	424.1	5.6	377.7	18.6
Import Coverage (months)	8.1	7.7		6.9	

Sources: NRBT

The surplus in both the current account and the capital account despite a deficit in the financial account supported the overall surplus balance. The current account surplus was mainly contributed by higher receipts of Government grants and cyclone relief funds from development partners as well as receipt of insurance payouts on TC Gita damages. Import payments were also lower over the month, mainly for wholesale & retail trade imports. Higher receipts of Government grants for investment projects explained the movements in the capital account surplus while the financial account deficit was due mainly to lower interbank transfer receipts.

Table 3: Overseas Exchange Transactions

	Monthly			Annual		
	Feb-18	Jan-18	% Growth	Feb-18	Feb-17	% Growth
Overall Balance	23.9	1.6	1392.8	70.3	49.1	43.1
Current Account	21.8	-6.3	-444.3	25.4	42.4	-40.1
Merchandise Trade	-26.2	-33.2	-21.2	-382.0	-322.4	18.5
Services	10.8	6.8	60.3	50.7	18.7	170.5
Income	0.9	-0.2	-567.6	-17.6	-2.6	565.4
Transfers	36.3	20.3	78.3	374.3	348.7	7.3
Capital Account	2.7	2.0	35.0	43.9	24.1	82.0
Financial Account*	-0.6	6.0	-109.2	1.0	-17.4	-105.9

* Includes unclassified transactions

Source: Banking System

In year ended terms, the current account balance recorded a lower surplus of \$25.4 million in comparison to a surplus



of \$42.4 million in February 2017. This was mainly attributed to higher import payments mainly for wholesale and retail trade, and supported by higher dividend payments. Capital account balance recorded a higher surplus over the year, due to an increase in both government and private receipts for investment projects and capital expenditures whereas financial account recorded a surplus after the deficit in the previous year, due mainly to higher interbank receipts.

Broad money increased over the month and over the year by 1.0% and 9.4% respectively. This stemmed from receipt of cyclone relief funds, consistent with the increase in the foreign reserves. However, net domestic assets fell over the month and over the year.

Table 4: Money Supply

	Monthly			Annual	
	Feb-18	Jan-18	% Growth	Feb-17	% Growth
Money Supply (\$ in million)	558.2	552.5	1.0	510.2	9.4
Net Foreign Asset	468.1	446.2	4.9	402.2	16.4
Net Domestic Asset	90.3	107.5	-15.9	108.3	-16.6

Source: Banking System, NRB

Liquidity in the banking system (reserve money) increased over February to \$297.6 million. This was largely driven by a \$7.0 million increase in currency in circulation as the commercial banks withdrew over \$5.0 million from the Reserve Bank vault to meet the public's high demand for cash. The banks' total loan to deposit ratio (including Government Development Loan (GDL) scheme) remained relatively stable at 76.2% in February, reflecting a proportionate growth in both total deposits and total loans of 0.5%. Total loans to deposit ratio (excluding GDL) slightly decreased to 74.7% in February from 74.8% last month. It continues to remain below the 80% minimum loan to deposit ratio which indicates excess liquidity in the banking system remains and that there is capacity for further lending by banks.

Table 5: Total Lending (including GDL)

Lending	Monthly			Annual	
	Feb-18	Jan-18	% Growth	Feb-17	% Growth
Total Lending (\$ in million)	439.5	437.5	0.5	384.5	14.3
Business lending	196.1	195.5	0.3	165.5	18.5
Household lending	242.6	241.2	0.6	217.9	11.3
Other lending	0.9	0.8	3.2	1.1	-23.3

Source: Banking System, NRB

Total banks' lending (including GDL) increased over the month due to more loans to households (housing loans) and businesses (construction, transport and wholesale & retail loans). Total lending (excluding GDL) also increased by \$1.8 million to \$431.2 million. Over the year, total banks' lending (including GDL) rose significantly due to higher lending to businesses including the public enterprises, wholesale & retail, and services sectors. Household loans also increased as a result of more loans for housing purposes. Lending (excluding GDL) also rose over the year by \$56.7 million. These movements continued to coincide with the strong domestic economic activities

evident throughout the year. Low interest rates from the GDL scheme partially supported the credit growth.

The weighted average interest rate spread widened over February and over the year to 5.791%. The monthly increase resulted from a rise in the weighted average lending rate (higher business lending rates particularly for manufacturing, fisheries, and construction sectors) outweighing the decline in the weighted average deposit rate (lower demand and term deposit rates). Over the year, the weighted average interest rate spread widened due to the increase in the weighted average lending rate (increase in both business and households lending rates) whilst the weighted average deposit rates remained relatively stable over the year.

Table 6: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Feb-18	Jan-18	Growth (bps)	Feb-17	Growth (bps)
Weighted Average Banks Deposit Rate (%)	2.161	2.204	-4.3	2.160	0.02
Weighted Average Banks Lending Rate (%)	7.952	7.925	2.7	7.856	9.6
Weighted Average Interest Rate Spread (%)	5.791	5.721	7.0	5.696	9.6

Source: Banking System, NRB

Net credit to Government continued to decline over the month by \$24.0 million due to high government deposits recorded during the month, supported by insurance claims, grants and financial assistance received from donors and bilateral partners for post-cyclone Gita recovery. Annually, net credit to government also declined by \$70.4 million which reflected the receipts of grants and project funds and as well as high revenue collection that were deposited during year.

The growth outlook for Tonga remains positive in the years ahead as projected by the Reserve Bank in its August 2017 MPS. Growth for 2017/18 will be reduced due to the impact of TC Gita but anticipated to be higher in 2018/19. The level of foreign reserves is expected to remain at comfortable levels well above the minimum range of 3-4 months of import cover supported by expected higher receipts of remittances and foreign aid. This will be partially offset by the projected rise in imports and the commencement of the Government's principal loan repayment to the EXIM Bank of China. Upward inflationary pressure remains in the near term and is expected to remain above the Reserve Bank's inflation reference rate of 5% per annum in 2018. 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 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.