



NATIONAL RESERVE BANK OF TONGA

MONTHLY ECONOMIC REVIEW

Vol. 5

No. 7

Month Ended: July 2018

International environment remains broadly stable

According to the International Monetary Fund's (IMF) World Economic Outlook Update released in July 2018, the global growth outlook of 3.9% for 2018 remains. US recorded a 4.2% strong growth in the second quarter of 2018 due to the robust private consumption, expansionary fiscal policy which pushed output further above potential and the unemployment rate falling below 4%. Growth in the second quarter of 2018 in the Australian economy was stronger than expected at 0.9% supported by strong domestic demand and foreign trade. New Zealand experienced mixed growth over the month of July as labour income continued to grow whilst consumer spending weakened.

Vibrant domestic economic activities over the month

Activities in the domestic economy picked up over the month as reflected by partial economic indicators, suggesting a vibrant start for the 2018/19 financial year. From the primary sector, the total volume of agricultural exports increased by 82.4 tonnes (19.1%) due to an increase in exported yam, taro and coconuts. The demand for individual housing continued to support activities in the secondary sector. Individual housing loans increased over the month by \$1.5 million (0.8%) and a 2.5% increase in loan for the mining and quarrying sector. In the tertiary sector, international air arrivals rose by 10.9% coinciding with a 28.6% increase to a total \$12.2 million of travel receipts, supported by the events took place during the month such as Heilala festival, school reunion and annual church conference. Container registrations increased by 15.6% as both business and private containers rose by 18.5% and 12.4% respectively reflecting a vibrant trade sector. In addition, as a partial indicator for the transportation sector, vehicle registrations rose by 38 vehicles (12.6%) and number of scheduled flights increase by 24 flights indicating a continued strong activity in the sector.

Consumption activities rose over the month as indicated by an increase in the Consumption Tax (CT) collected over the month and businesses' total sales. This coincided with the increase in total containers and a \$2.6 million (13.0%) increase in wholesale & retail import payment. Banks' lending to households also increased by \$1.7 million (0.7%) which may have translated into solid consumer spending. This is supported by remittance receipts and new loan commitments over the month. Total remittances continued to remain high at \$29.8 million despite the slight decrease over the month. New loan commitments increased in July for wholesale & retail, construction, fisheries and tourism sectors. The anticipated rise in remittance receipts and the continuous increase in new loan commitments to households will support strong consumption spending in the future.

Below average rainfall is expected

The rainfall recorded in July 2018 was below average where Nuku'alofa recorded the lowest rainfall. Tonga

Meteorological Service¹ in its latest update indicated that the rainfall has been below average in August 2018 and is expected to continue recording below average rainfall in the near term. This will pose an impact in the primary sector and other sectors of the economy in the future.

Partial indicator of employment declined

The total number of job advertisements² fell over the month by 65 job vacancies following the higher number of advertised jobs in the previous month. Over the year to July, the number of vacancies advertised decreased by 8 vacancies (2.9%) as lower advertisements was recorded for the services and industrial sectors. However, the outlook for strong growth in the domestic economy is expected to support a lower unemployment rate³ for Tonga.

Inflationary pressure continues

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Jul-18	Jun-18	Jul-18	Jun-18
Headline Inflation (%)	-0.1	-2.5	6.1	5.9
Domestic prices	-0.9	-6.3	6.2	4.5
Imported prices	0.6	0.8	6.0	6.9

Source: Statistics Department

Favourable movement in both local and imported food prices drove the continued decline in the monthly inflation. A decline in domestic prices over the month was driven by a 4.8% fall in the domestic fruit and vegetable price. This reflected in lower prices for tomatoes, carrots, capsicum and green coconuts. This outweighed an increase in the prices of meat, fish & poultry like octopus, tuna and eggs. Imported prices however rose due to an increase in the prices of tobacco. The revised excise taxes on imported tobacco drove its price higher by 6.8%.

Table 2: Items contributing to domestic inflation

Items (\$ per kg)	Monthly			Annual	
	Jul-18	Jun-18	Growth	Jul-17	Growth
Tomatoes	\$6.46	\$11.05	-\$4.59	\$7.27	-\$0.81
Carrots	\$3.76	\$7.00	-\$3.24	\$4.51	-\$0.75
Capsicum	\$20.41	\$22.42	-\$2.01	\$12.18	\$8.23
Pineapple	\$7.90	\$8.35	-\$0.45	\$12.40	-\$4.50
Coconut (green)	\$1.81	\$2.07	-\$0.26	\$2.27	-\$0.46
Yam, late	\$2.38	\$2.48	-\$0.10	\$2.65	-\$0.27
Octopus	\$18.44	\$15.75	\$2.69	\$16.98	\$1.46
Tuna	\$16.00	\$15.00	\$1.00	\$15.00	\$1.00
Egg	\$17.13	\$16.63	\$0.50	\$16.63	\$0.50
Kava-Tonga	\$150.00	\$150.00	\$0.00	\$103.00	\$47.00

Source: Statistics Department

Despite the fall in the monthly inflation rate, the annual headline inflation increased to 6.1%. This was attributed to lower commodity prices in July 2017 compared to the current period. This was due to higher prices of imported food, fuel and tobacco for items such as oranges, potatoes, mutton flaps, Winfield blue, diesel and petrol. The domestic prices also rose with food items (capsicum, ripe banana, pawpaw, head cabbage, watermelon) as the lead contributor followed by kava-Tonga.

¹ Issued by the Ministry of Meteorology, Energy, Information, Disaster Management, Environment, and Climate Change & Communication on 10th September 2018.

² Based on data collected by the Reserve Bank

³ Unemployment rate of 1.1% refer to not working, available & looking for work, 16.4% refer to not working, available & willing to work and 34.8% refer to including subsistence workers



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Exchange Rates remain competitive

Table 3: Exchange Rates

	Monthly			Annual	
	Jul-18	Jun-18	% Growth	Jul-17	% Growth
Nominal Effective Exchange Rate Index	91.1	90.9	0.2	91.4	-0.3
Real Effective Exchange Rate Index	107.7	105.4	2.2	104.5	3.0

Source: National Reserve Bank of Tonga

The depreciation of the USD and CNY against the TOP outweighed the appreciation of the NZD and AUD over the month. The USD weakened against most major currencies on flatter US yield curve whilst other currencies appreciated over the month on the back of the weakening USD. As a result, the Nominal Effective Exchange Rate (NEER) index slightly increased in July 2018. The rise in the Real Effective Exchange Rate (REER) index over the month and year reflected Tonga's higher headline inflation rate relative to its trading partners.

Table 4: Bilateral Exchange Rates

	Jul-18	Jun-18	Jul-17
USD/TOP	0.4416	0.4397	0.4667
AUD/TOP	0.5961	0.5985	0.5845
NZD/TOP	0.6471	0.6515	0.6218
FJD/TOP	0.9225	0.9211	0.9342
JPY/TOP	49.0286	48.6418	51.6334
GBP/TOP	0.3362	0.3365	0.3554
EUR/TOP	0.3771	0.3805	0.3973
CNY/TOP	3.0095	2.9139	3.1443

Source: National Reserve Bank of Tonga

Table 5: Foreign Reserves

	Monthly			Annual	
	Jul-18	Jun-18	% Growth	Jul-17	% Growth
Foreign Reserves (\$ in million)	476.5	468.7	1.7	408.9	14.6
Import Coverage (months)	7.9	7.8		7.5	

Source: National Reserve Bank of Tonga

Foreign Reserves continued to increase

In July 2018, the overall balance of Overseas Exchange Transaction (OET) recorded a surplus, but lower in comparison to the previous month. This resulted from a decline in official transfer receipts. The official foreign reserves therefore increased to \$476.5 million, which is equivalent to 7.9 months of import cover.

Lower official receipts drives the narrowing of the overall surplus

Table 6: Overseas Exchange Transactions

	Monthly			Annual		
	Jul-18	Jun-18	% Growth	Jul-18	Jul-17	% Growth
Overall Balance	7.7	26.8	-71.1	67.6	41.5	62.9
Current Account	0.5	27.5	-98.2	12.6	44.2	-71.4
Merchandise Trade	-36.7	-35.3	4.0	-390.9	-345.8	13.1
Services	5.9	-2.2	-375.5	24.2	39.4	-38.5
Income	1.6	-3.7	-142.7	-6.3	-18.6	-66.1
Transfers	29.7	68.6	-56.7	385.7	369.2	4.5
Capital Account	3.8	3.5	11.3	41.5	29.8	39.5
Financial Account	3.4	-4.1	-182.9	13.4	-32.5	-141.2

Source: Banking System

The official transfer receipts decreased over the month, following a peak in June from inflows of cyclone relief and project funds. The merchandise trade deficit widened over the month due to lower export receipts mainly from agricultural and other exports. Import payments however slightly rose due to higher import payments on wholesale and retail goods and also import of vehicles. Over the year, the overall OET balance grew stronger as a result of all three accounts recorded surpluses with capital account again contributed the most. This was driven by higher official and private capital receipts particularly for construction purposes. Although the remittances and

official transfer receipts increased, the widening of the merchandise trade deficit drove the lower current account surplus in July. Import payments rose by 11.3% over the year attributed to higher imports of wholesale and retail goods.

Record High for Broad Money

Table 7: Broad Money

	Monthly			Annual	
	Jul-18	Jun-18	% Growth	Jun-17	% Growth
Broad money (\$ in million)	606.1	575.5	5.3	533.2	13.7
Net Foreign Asset	497.5	485.3	2.5	426.5	16.7
Net Domestic Asset	108.9	90.4	20.4	106.9	1.8

Source: Banking System, National Reserve Bank of Tonga

The decline in Government deposits, due to implementation of donor funded projects drove the increase in net credit to government which resulted an expansion in domestic assets and broad money in July 2018. The increase in foreign reserves contributed to the higher foreign assets. Over the year, broad money rose significantly mainly as a result of an increase in the foreign reserves. This attributed to receipts of budgetary support, grants and cyclone relief funds from development partners and higher remittances during the year.

Liquidity continued to rise

Table 8: Reserve money

	Monthly			Annual	
	Jul-18	Jun-18	% Growth	Jul-17	% Growth
Reserve money (\$ in million)	332.3	317.7	4.6	278.4	19.4

Source: Banking System, National Reserve Bank of Tonga

The banking system remained sound and maintained strong capital position, supported by comfortable profitability, and non-performing loans continued to remain low. Liquidity in the banking system (reserve money) increased for the third consecutive months due to an increase in deposits by the commercial banks to the Reserve Bank's vault. Higher deposits outweighed the growth in lending over the month resulted in a decrease in the loans to deposit ratio from 73.3% last month to 70.9% in July. This continued to remain below the 80% minimum loan to deposit ratio which indicates excess liquidity in the banking system and that there is capacity for further lending by the banks.

2018/19 starts positively for business lending

Table 9: Total Lending

	Monthly			Annual	
	Jul-18	Jun-18	% Growth	Jul-17	% Growth
Total Lending (\$ in million)	452.9	447.3	1.2	407.1	11.3
Business lending	202.7	198.8	2.0	176.0	15.1
Household lending	249.4	247.7	0.7	229.9	8.5
Other lending	0.820	0.855	-4.1	1.19	-30.9

Source: Banking System, National Reserve Bank of Tonga

Total banks' lending to businesses contributed the most to the monthly and annual movements in credit growth. Over the month, lending to the public enterprises, wholesale & retail and agricultural sectors rose whilst higher loans to public enterprises, wholesale & retails, tourism, transport and fisheries drove the annual growth in business loans. The Government Development Loans continued to support the credit growth and the economic activities in these



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sectors. The consistent rise in wholesale & retail loans coincided with higher import payments for wholesale & retail goods and higher container registrations. The monthly and annual growth in household loans both resulted solely from the rising demand for housing loans and their continued capacity to access loans.

Weighted average interest rate spread widened further

Table 10: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Jul-18	Jun-18	Growth (bps)	Jul-18	Growth (bps)
Weighted Average Banks Deposit Rate (%)	2.019	2.027	-0.8	2.189	-17.0
Weighted Average Banks Lending Rate (%)	8.062	7.944	11.8	7.848	21.4
Weighted Average Interest Rate Spread (%)	6.043	5.917	12.6	5.659	38.4

Source: Banking System, National Reserve Bank of Tonga

The weighted average interest rate spread continued to widen over the month and year due to movements in volume. This resulted from a widening weighted average lending rate outweighing the decline in the weighted average deposit rate. The increase in the weighted average lending rate was driven by higher lending and rise in lending rates for the agricultural and fisheries sectors. The decline in the weighted average deposit rate was due mainly to significant increase in the volume of deposits although the increase in the term and saving deposit rates over July.

Foreign Exchange Dealers have more access points

Foreign Exchange Dealers (FEDs) continued to be the preferred channel for receiving of remittances. A 88.2%

share of total remittances were received via FEDs in July 2018 compared to a 87.5% share recorded last month. The general public continued to prefer sending and receiving money via FEDs compared to banks, as FEDs have more access points and their services are much quicker. The number of inter-island transactions however declined by 18 transactions over July.

Outlook

Given the recent developments, 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 budgetary support and grant funds from development partners and expected higher receipts of remittances. This will be partially offset by the anticipated increase in imports and the Government's external loan repayments. Inflation is expected to fall below the Reserve Bank's inflation reference rate of 5% per annum at the end of 2018. The Reserve Bank will continue to closely monitor developments in the domestic and global economies to ensure financial and macroeconomic stability are maintained and to change its monetary policy setting where necessary to support its monetary policy objectives.