

### Slow global growth continues

The US experienced slower consumer spending and business investments in August due to the impact of the rising tariffs and a slowing global economy. Tonga's other major trading partners, such as Australia and New Zealand, both experienced soft growth. Growth in Australia was mainly due to subdued growth in household income, weighing on consumption spending. This resulted in the Reserve Bank of Australia (RBA) lowering the cash rate in June and July to a new low of 1.0%. Meanwhile, the Reserve Bank of New Zealand's 0.5% reduction in the official cash rate stemmed from slow GDP growth and low inflation.

### Mixed Domestic economic activities

Indicators of economic activity were generally mixed in August. The total agricultural exports declined by 20.3 tonnes (3.0%) due to lower exports of root crops such as taro, which declined by 37.5 tonnes (22.1%), sweet potato by 5.7 tonnes (29.5%), and yams by 4.3 tonnes (1.6%). Meanwhile, squash exports have commenced in August with 26.9 tonnes, and are expected to rise in the following months. Consequently, agricultural export proceeds increased by \$0.4 million (49.6%) over the month, while marine export proceeds also rose by \$0.3 million (39.2%). Over the year, export proceeds rose by 5.9%, owing mostly to marine exports.

The industry sector continues to benefit from active construction activities such as school reconstruction, church buildings, and private household constructions. Banks' loans for individual housing and the construction sector have increased over the month by \$0.2 million (0.1%) and \$0.2 million (1.9%), respectively. Individual housing loans grew over the year by \$8.7 million (4.5%). The road development project continues to benefit the manufacturing, mining and quarrying sectors.

Activities in the tertiary sector were mixed. The number of container registrations rose by 61 registrations (6.7%) and was driven solely by higher business containers, which increased by 107 registrations (20.7%), signaling more consumer spending. International air arrivals and departures declined by 1,090 passengers (9.5%) and 1,975 (15.4%), respectively, following a peak in July. However, these air arrival levels remain relatively high, reflecting the high movement of travellers to and from Tonga in August. This is attributed to various regional and international conferences hosted in Tonga and sports events such as the Ikale Tahi rugby team home game against the Western Force, which attracted visitors to Tonga. Vehicle registrations, however, decreased by five vehicles (1.5%) over the month.

### Lower employment opportunities available

The Reserve Bank survey on job advertisements shows lower job advertisements in August by 15.4% (6 vacancies) compared to July. Majority of the August vacancies were for the transport and communication

sector, reflecting business expansions and employees transferring to other sectors or migrating overseas. In year ended terms, total advertised vacancies grew by 1.0% (4 vacancies) as a result of higher recruitment intentions, which may improve Tonga's unemployment rate.

### Annual headline deflation continues

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Aug-19	Jul-19	Aug-19	Aug-18
<b>Headline Inflation (%)</b>	<b>0.5</b>	<b>0.2</b>	<b>-0.1</b>	<b>6.1</b>
Domestic prices	0.0	0.2	-2.5	6.6
Imported prices	0.8	0.2	1.9	5.5

Source: Statistics Department

Headline inflation increased by 0.5% for the month of August, driven by a rise in import prices of 0.8%, while overall domestic prices remain at the same level. The higher imported prices were mostly from imported food such as fruits, meat, and poultry offsetting the lower fuel prices. Meanwhile, domestic prices recorded no change as rises in prices of some of the local root crops, fruits, and

Table 2: 'Average prices of selected domestic items'

Items (\$ per kg)	Unit	Monthly			Annual	
		Aug-19	Jul-19	Change	Aug-18	Change
Kava	1 kg	\$112.50	\$115.00	-\$2.50	\$150.00	-\$37.50
Lu	1 kg	\$4.34	\$3.65	\$0.69	\$6.88	-\$2.54
Carrots	1 kg	\$2.45	\$3.88	-\$1.43	\$3.72	-\$1.27
Yams-late	1kg	\$2.47	\$2.70	-\$0.23	\$3.39	-\$0.92
Kumala	1 kg	\$1.96	\$2.12	-\$0.16	\$2.52	-\$0.56
Cockles (to'o)	1kg	\$5.81	\$7.01	-\$1.20	\$6.27	-\$0.46
Eggs	1 tray	\$17.33	\$17.83	-\$0.50	\$17.63	-\$0.30
Talo-Futuna	1 kg	\$1.52	\$1.72	-\$0.20	\$1.77	-\$0.25
Talo-Tonga	1 kg	\$1.68	\$1.94	-\$0.26	\$1.84	-\$0.16
Yams-early	1kg	\$6.33	\$4.92	\$1.41	\$6.28	\$0.05
H/cabbage	1 kg	\$2.09	\$1.41	\$0.68	\$1.90	\$0.19
Tuna	1kg	\$17.56	\$17.00	\$0.56	\$16.00	\$1.56

Source: Statistics Department

vegetables were mostly offset by the declining price of kava-Tonga.

Over the year to August, headline deflation of 0.1% was recorded and was due to domestic prices declining by 2.5%, offsetting a 1.9% rise in imported prices. The decline in domestic inflation was driven by lower prices of Kava-Tonga, food items such as local fruit and vegetables, and root crops as outlined in Table 2 above. This reflects improved supply of local food and kava-Tonga as the agriculture sector continues to recover from the impacts of Cyclone Gita. On the other hand, import prices rose by 1.9% due to higher prices for all groups except transport, which declined due to lower fuel prices. This is underpinned by the strengthening of the major trading partner currencies against the TOP, and Tonga's vulnerability to external shocks and global prices.

### Competitive exchange rates

# NATIONAL RESERVE BANK OF TONGA

## MONTHLY ECONOMIC REVIEW

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Month Ended: August 2019

Table 3: Effective Exchange Rates

	Monthly			Annual	
	Aug-19	Jul-19	% Growth	Aug-18	% Growth
Nominal Effective Exchange Rate Index	92.8	91.9	1.0	91.5	1.4
Real Effective Exchange Rate Index	107.7	106.4	1.3	107.8	-0.1

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) index slightly increased over the month and the year, reflecting a general weakening of the trading partner currencies against the TOP except for USD and JPY. The Real Effective Exchange Rate (REER) index also increased over the month but declined over the year, supporting Tonga's international competitiveness.

Table 4: Bilateral Exchange Rates

	Aug-19	Jul-19	Aug-18
USD/TOP	0.4325	0.4392	0.4390
AUD/TOP	0.6371	0.6272	0.5971
NZD/TOP	0.6706	0.6562	0.6570
FJD/TOP	0.8920	0.8960	0.8884
JPY/TOP	45.8792	47.4258	48.6402
GBP/TOP	0.3548	0.3507	0.3398
EUR/TOP	0.3877	0.3903	0.3793
CNY/TOP	2.8140	2.8573	2.8563

Source: Banking Systems

### Higher import payments in August

Table 5: Foreign Reserves

	Monthly			Annual	
	Aug-19	Jul-19	% Growth	Aug-18	% Growth
Foreign Reserves (\$ in million)	491.8	492.9	-0.2	475.0	3.5
Import Coverage (months)	7.9	8.0		8.1	

Source: National Reserve Bank Tonga

Official foreign reserves remain comfortable despite a \$1.1 million (0.2%) decline to \$491.8 million (equivalent to 7.9 months of imports cover) in August 2019, due mainly to oil and other import payments. Over the year, foreign reserves rose by \$16.0 million (3.5%). However, the months of import cover slightly declined from 8.1, reflecting higher imports of goods and services relative to the same period last year.

Table 6: Overseas Exchange Transactions  
Overseas Exchange Transactions

	Monthly			Annual		
	Aug-19	Jul-19	% Growth	Aug-19	Aug-18	% Growth
Overall Balance	-1.1	8.6	-113.1	16.8	70.0	-76.0
Current Account	-1.4	0.4	-416.3	1.2	11.1	-89.4
Merchandise Trade	-36.2	-33.9	-6.9	-421.1	-390.1	-7.9
Services	1.7	6.0	-71.5	31.7	22.2	43.0
Income	0.8	1.2	-39.4	7.0	-1.9	459.9
Transfers	32.4	27.1	19.5	383.5	381.0	0.7
Capital Account	1.2	0.2	448.9	37.3	39.8	-6.2
Financial Account	-0.9	8.0	-111.8	-21.7	19.1	-213.5

Source: Banking Systems

The overall Overseas Exchange Transactions (OET) balance recorded a deficit of \$1.1 million in August 2019 due to higher current and financial account payments. Current account payments were mainly for oil and wholesale & retail imports, whereas financial account payments were for interbank payments. These outweighed the rise in remittances receipts and export proceeds.

Annually, the OET balance surplus lowered due to higher outflows from all three accounts, with the most outflows made from financial account mainly for interbank transfers and offshore investments. The current account surplus was also lower, mostly due to payments for imports of goods and services. These payments partially offset the rise in receipts from travel, remittance, and earned income.

### Broad money expanded to a new high level

Table 7: Broad Money

	Monthly			Annual	
	Aug-19	Jul-19	% Growth	Aug-18	% Growth
Broad money (\$ in million)	608.6	598.1	1.7	606.0	0.4
Net Foreign Asset	510.9	510.0	0.2	494.1	3.4
Net Domestic Asset	98.1	88.6	10.7	112.2	-12.6

Source: Banking System, National Reserve Bank of Tonga

Broad money expanded to \$608.6 million (1.7%) on higher net domestic assets stemming from higher net credit to government and credit to private sectors. This was also supported by the slight rise in net foreign assets from lower foreign liabilities.

### Liquidity continues to rise

Table 8: Reserve money

	Monthly			Annual	
	Aug-19	Jul-19	% Growth	Aug-18	% Growth
Reserve money (\$ in million)	311.3	309.0	0.8	334.2	-6.9

Source: Banking System, National Reserve Bank of Tonga

Liquidity in the banking system rose again in August by \$2.3 million (0.8%) to \$311.3 million, although it is \$22.9 million (6.9%) lower than the same month last year. The monthly rise was due mainly to higher banks exchange settlement accounts on the increase in deposits from the commercial banks to the Reserve Bank vault, supported by the slight rise in required reserves. The banks' total loans to deposit ratio slightly rose from 78.4% to 79.0% over the month, reflecting loans increasing at a faster pace than the increase in deposits.

### Business investments drive credit growth

Table 9: Total Lending

Lending	Monthly			Annual	
	Aug-19	Jul-19	% Growth	Aug-18	% Growth
Total Lending (\$ in million)	496.8	491.1	1.2	457.5	8.6
Household lending	259.2	259.2	0.0	251.1	3.2
Business lending	237.4	231.7	2.4	206.9	14.8
Other lending	0.2	0.2	8.3	0.7	-66.3

Source: Banking System, National Reserve Bank of Tonga

Higher lending to businesses continued to drive the increase in total lending both over the month and year to a new high level of \$496.8 million. Majority of the business loans for the month were for public enterprises, professional & other services, wholesale and retail, and agricultural sectors. Annually, majority of the loans were for the state-owned enterprises, wholesale & retail, professional & other services, tourism, and transport sectors. This may reflect higher business sentiment and confidence. Household loans also grew over the year, mostly for housing loans.

### Interest rate spread widened

Table 10: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Aug-19	Jul-19	Growth (bps)	Aug-18	Growth (bps)
Weighted Average Banks Deposit Rate (%)	1.924	1.925	-0.1	1.980	-5.6
Weighted Average Banks Lending Rate (%)	8.036	8.033	0.3	8.076	-4.0
Weighted Average Interest Rate Spread (%)	6.112	6.108	0.4	6.096	1.6

Source: Banking System, National Reserve Bank of Tonga

Over the month and year to August 2019, the weighted average interest rate spread widened by 0.4 basis points and 1.6 basis points, respectively, to 6.11%. The monthly rise was due mainly to an increase in weighted average lending rates coupled with a decline in weighted average deposit rates. Higher lending rates were mostly for businesses such as construction, professional & other services, manufacturing, and fisheries sectors, as well as household housing and vehicle loans. On the other hand, lower deposits rates were solely driven by declining demand deposits rates.

The annual rise in weighted average interest rate spread was underpinned by the decrease in weighted average deposit rates at a faster pace than the decline in weighted average lending rates. Demand deposit rates fell again supported by lower time deposit rates, whereas lower lending rates were mainly for businesses such as tourism, agriculture, transport, and construction sectors.

### Outlook

The Reserve Bank continues to expect positive domestic economic activity in the medium term. Foreign reserves remain at comfortable levels above the minimum of 3 months of imports cover, while inflation is below the Reserve Bank's reference rate of 5%. Credit growth is expected to remain strong underpinned by excess liquidity in the banking system and banks new strategies and competition for lending. The Reserve Bank considers its current accommodative monetary policy stance appropriate at this time. However, the Reserve Bank continues to be vigilant in closely monitoring developments in the domestic and global economies and stands ready to adjust its monetary policies, to ensure financial and macroeconomic stability are maintained.