

Chances of a global recession are low

The Organization for Economic Cooperation and Development (OECD) has released data in February depicting the global growth slowdown which is expected to continue until 2020. However, the risk of a worldwide recession occurring is low, and growth is only projected to be below potential in most economies and regions. The US experienced slowed economic growth at an annualized rate of 2.6% in the last quarter of 2018 as released by the Federal Reserve this month. This was largely backed by slowing consumption activity despite more jobs created over the month. As for Tonga's other main trading partners, Australia, and New Zealand, they both reported softer than expected growth. Both dampening results are due to tightening labour markets and trade as well as inflationary pressures.

Economic activity experiences mixed growth in February

Economic conditions were mixed over the month after recording a slow growth in January. In the primary sector, the agricultural exports volume increased by 31.3 tonnes mainly due to a 54.3 tonnes increase in the exports of root crops mostly cassava and yam. This was offset by a 23.3 tonnes decrease in exports of fruit products particularly green coconuts. Activities in the secondary sector slowed in February. Total lending for the construction and mining & quarrying sectors however declined by 5.7% and 4.9% respectively. Nonetheless, new commitments loans to construction businesses increased during the month. Banks' lending to individuals for housing increased by 0.5%. Lending to the manufacturing sector also rose by 6.8%. Electricity consumption rose by 0.8% in February coinciding with a 0.2% rise in electricity consumers which also reflects the increase in new houses constructed. Activities in the tertiary sector were mixed. The number of container registrations declined by 240 registrations (28.3%). This was mainly driven by lower private containers which fell by 100 registrations (32.7%). International air arrivals also declined in February by 44.6%. Nonetheless, five cruise ships arrived during the month which supported activities in the tourism sector and transport sector.

Employment opportunities remain positive

More jobs were available in February evident from an increase in the total number of job advertisements by 32. This was due to recruitment intentions in all sectors particularly the services sector. These job vacancies may contribute to reducing the unemployment rate.

Annual headline inflation remains low

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Feb-19	Jan-19	Feb-19	Feb-18
Headline Inflation (%)	0.1	0.3	3.2	3.7
Domestic prices	0.9	2.5	8.5	-1.9
Imported prices	-0.5	-1.5	-1.0	8.1

Source: Statistics Department, NRBT

Headline inflation increased over the month by 0.1% mainly due to the rise in local food prices. Domestic inflation rose by 0.9% at the end of February

Table 2: Items contributing to annual domestic inflation

Items (\$ per kg)	Monthly			Annual	
	Feb-19	Jan-19	Change	Feb-19	Change
H/cabbage	\$5.34	\$4.93	\$0.41	\$1.62	\$3.72
Tuna	\$16.00	\$16.00	\$0.00	\$15.00	\$1.00
Capiscum	\$11.27	\$8.69	\$2.58	\$6.55	\$4.72
Tomatoes	\$14.19	\$10.74	\$3.45	\$13.02	\$1.17
Cockles(to'o)	\$5.14	\$5.08	\$0.06	\$3.70	\$1.44
Cassava	\$1.61	\$1.45	\$0.16	\$0.60	\$1.01
Carrots	\$4.72	\$3.10	\$1.62	\$3.91	\$0.81

Source: Statistics Department, NRBT

driven by the seasonality of local root crops which drove prices up for items such as cassava, tomatoes, cabbage and capsicum. On the other hand, imported prices decreased by 0.5% due to the decline in petrol and diesel prices which fell by 2.8% and 3.0% respectively. This was due to lower global oil prices.

Despite the slight increase over the month, annual headline inflation remained low recording a 3.2% rise in February 2019. The domestic and imported component of inflation contributed 3.8% and negative 0.5% percentage points respectively to the annual headline inflation. The annual rise in domestic prices is attributed to prices of food, tobacco, restaurants and hotels while the imported component declined mostly from transports services.

Exchange Rates remained stable

Table 3: Exchange Rates

	Monthly			Annual	
	Feb-19	Jan-19	% Growth	Feb-18	% Growth
Nominal Effective Exchange Rate Index	91.5	91.4	0.1	90.3	1.3
Real Effective Exchange Rate Index	105.8	107.4	-1.5	103.5	2.2

Source: National Reserve Bank of Tonga

In February 2019, the AUD, JPY and EUR depreciated against the TOP leading to a marginal rise in the Nominal Effective Exchange Rate (NEER) index. However, the Real Effective Exchange

Table 4: Bilateral Exchange Rates

	Feb-19	Jan-19	Feb-18
USD/TOP	0.4431	0.4448	0.4577
AUD/TOP	0.6208	0.6136	0.5866
NZD/TOP	0.6478	0.6459	0.6317
FJD/TOP	0.9346	0.9444	0.9269
JPY/TOP	49.1952	48.5610	49.1387
GBP/TOP	0.3331	0.3393	0.3286
EUR/TOP	0.3897	0.3877	0.3739
CNY/TOP	2.9631	2.9875	2.8913

Source: National Reserve Bank of Tonga

Rate (REER) slightly declined over the month but rose on an annual basis due to Tonga's higher headline inflation compared to its trading partners.

Foreign reserves remain comfortable

Table 5: Foreign Reserves

	Monthly			Annual	
	Feb-19	Jan-19	% Growth	Feb-18	% Growth
Foreign Reserves (\$ in million)	473.5	478.9	-1.1	448.0	5.7
Import Coverage (months)	7.9	8.0		7.9	

Source: National Reserve Bank Tonga

Although the level of foreign reserves declined in February, it has remained above 7¹ months of imports cover since May 2017. The decline was due to the increase in payments from both the current and financial accounts.

Table 6: Overseas Exchange Transactions

	Monthly			Annual		
	Feb-19	Jan-19	% Growth	Feb-19	Feb-18	% Growth
Overall Balance	-5.5	0.4	-1321.2	25.5	70.3	-63.8
Current Account	-12.6	-9.7	29.1	-9.6	26.3	-136.3
Merchandise Trade	-34.3	-32.3	6.3	-420.4	-382.4	9.9
Services	-2.3	1.1	-316.9	11.0	50.3	-78.1
Income	1.5	1.5	-1.7	7.7	-16.8	-145.5
Transfers	22.6	20.0	12.7	392.1	375.2	4.5
Capital Account	1.3	8.8	-84.9	33.4	43.9	-24.0
Financial Account	-0.1	0.9	-111.1	1.7	0.1	1541.1

Source: Banking Systems

A Balance of Payments (OET) deficit was recorded in February 2019 and was attributed to inter-bank payments and repatriation of funds. This was followed by an increase in total import payments mainly for government goods and services, and wholesale & retail goods. Total receipts also declined over the month due to lower private capital receipts and a decline in travel receipts which coincided with lower international air arrivals. However, receipts of grants for both government and non-profit organizations contributed to the increase in current transfers.

Over the year, the surpluses in the financial and capital account contributed to the OET balance of payments surplus and outweighed a deficit in the current account. This was however a lower overall surplus as the merchandise trade deficit widened due to higher imports compared to exports.

Broad money declined further

The lower foreign reserves pushed net foreign assets lower which further decreased broad money. This outweighed a slight rise in net domestic assets mainly due to a fall in government deposits. Over the year, higher net domestic assets and net foreign assets increased broad money. Again the higher foreign reserves supported the rise in net foreign assets while higher credit to the private sector drove the increase in net domestic assets. Receipts of budgetary support, grants, cyclone relief funds from

development partners and remittances continued to contribute to the higher foreign reserves.

Table 7: Broad Money

	Monthly			Annual	
	Feb-19	Jan-19	% Growth	Feb-18	% Growth
Broad money (\$ in million)	589.0	598.3	-1.6	558.2	5.5
Net Foreign Asset	492.6	502.2	-1.9	468.1	5.2
Net Domestic Asset	96.7	96.4	0.4	90.3	7.1

Source: Banking System, National Reserve Bank of Tonga

Excess liquidity remains

Liquidity in the banking system fell by \$5.5 million over the month to \$320.6 million, largely driven by a

Table 8: Reserve money

	Monthly			Annual	
	Feb-19	Jan-19	% Growth	Feb-18	% Growth
Reserve money (\$ in million)	320.6	326.2	-1.7	297.6	7.7

Source: Banking System, National Reserve Bank of Tonga

fall in currency in circulation due to less demand indicating winding down of activities after the Christmas and new year festivities. The banks' total loans to deposit ratio increased over the month from 74.8% in the previous month to 76.0%, reflecting the fall in deposits which outweighed the growth in loans.

Pace of credit growth slows

Total lending slightly grew by 0.2% over the month to \$483.7 million compared to a 0.6% rise last month.

Table 9: Total Lending

Lending	Monthly			Annual	
	Feb-19	Jan-19	% Growth	Feb-18	% Growth
Total Lending (\$ in million)	483.7	482.8	0.2	439.5	10.1
Business lending	222.6	222.3	0.1	197.3	12.8
Household lending	260.8	260.2	0.2	242.6	7.5
Other lending	0.3	0.3	10.0	0.9	-62.7

Source: Banking System, National Reserve Bank of Tonga

Over the year, credit growth rose by 10.1% compared to a 10.4% increase last year reflecting further declines in lending to fisheries, entertainment & catering and communication sectors.

Weighted average interest rate spread widened

Table 10: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Feb-19	Jan-19	Growth (bps)	Feb-18	Growth (bps)
Weighted Average Banks Deposit Rate (%)	1.902	1.882	2.0	2.106	-20.4
Weighted Average Banks Lending Rate (%)	8.287	8.092	19.5	7.922	36.5
Weighted Average Interest Rate Spread (%)	6.385	6.210	17.5	5.816	57.0

Source: Banking System, National Reserve Bank of Tonga

The weighted average lending rates increased more than the increase in weighted average deposit rates. As a result the weighted average interest rate spread widened in February 2019 to 6.39%. Higher weighted average lending rate was mostly for public enterprises, fisheries, construction and manufacturing sectors as well as household loans mainly vehicle and housing loans. Similarly, the increase in time deposit rates was largely driven by an increase in saving rates which outweighed the decline in both demand and time deposit rates.

¹ Revisions to the Months of Imports was due to the receipt of updated Trade data from the Statistics Department for June & September 2018 quarter.

The annual trend continued with a decline in the weighted average deposit rates while the weighted average lending rates increased. The increase in the weighted average lending rate stemmed from higher interest rates offered to public enterprises, agricultural, fisheries and distribution sectors as well as households for housing and other personal loans. On the other hand, the decline in the weighted average deposit rates were mainly for time and demand deposit rates.

Outlook

The Reserve Bank expects strong domestic economic activity to remain in the medium term. Furthermore, the foreign reserves is expected to remain at comfortable levels and inflation to remain below the Reserve Bank's inflation reference rate of 5% per annum throughout 2019. Therefore, the Reserve Bank will continue with the current monetary policy measures to ensure external viability and external stability.