

### Tonga's major trading partners expanded in March 2019 quarter

The U.S economy recorded a 3.1% growth in the first quarter of 2019, due to a boost in net trade and inventory investment. Yet, global trade tensions escalated in May as the US government announced new tariffs on China and Mexico. The New Zealand economy expanded in the March 2019 quarter, in line with expectations. Gross domestic production rose by 0.6%, led by growth in the construction sector. The Australian economy also grew by 0.4% in the March quarter driven by government spending and exports. However, both the Reserve Bank of New Zealand (RBNZ) and Reserve Bank of Australia (RBA) announced Official Cash Rate (OCR) cuts in May and early June respectively. The RBNZ lowered the OCR by 25 basis points to 1.5% due to weak global and domestic economic activities and weakening inflation pressure. The RBA also reduced the OCR by 25 basis points to 1.25% due to subdued inflationary pressure and to support employment growth.

### Mixed sectoral performance in May

Partial data indicated that the primary sector had mixed performance in the month of May 2019. Receipts from exports of agricultural products rose by 95.9% (\$0.3 million) during the month while proceeds from marine products slightly fell by 16.5% (\$0.1 million). Over the year, export proceeds for agricultural and marine products both grew by 1.3% (\$0.1 million) and 41.9% (\$2.3 million) respectively. Growth in lending to the agricultural sector by 10.4% in May is expected to support the sector's growth in the medium term.

Lending to the manufacturing and construction sectors grew by 1.6% and 0.2% respectively in May, suggesting positive activities in the industry sector. This growth in lending is further supported by a 0.2% growth in individual housing loans and a 0.3% growth in loans to the utility sector. Payments for imports of construction materials also rose by 37.5%, supporting the industry sector.

Economic activities in the tertiary sector were mostly positive. Total air arrivals rose by 30.5% coinciding with the increase in the number of international flights landing in Tonga. Consequently, travel receipts also increased by 40.9% (\$3.5 million). Payment for imports of wholesale and retail goods also rose by 31.4% supporting the trade sector. However, the total number of container registrations decreased by 1.0% (8 containers). The lower number of business containers drove this decline and outweighed the increase in private containers.

### Positive employment opportunities

The Reserve Bank's survey of job advertisements recorded an increase of 22 vacancies over the month and over the year by 142 vacancies. This increase was mostly driven by advertisements for Public administration, which may contribute to lower unemployment rates in the near term.

### Higher inflation recorded in May

Table 1: Inflation Rates

Prices	Monthly		Annual	
	May-19	Apr-19	May-19	May-18
Headline Inflation (%)	0.8	-1.6	1.6	3.8
Domestic prices	-0.2	-4.2	1.5	-1.1
Imported prices	1.7	0.6	1.7	7.5

Source: Statistics Department

The headline inflation increased over the month to 0.8% compared to a 1.6% deflation last month. This was due mainly to rising imported prices in May. The 1.7% rise in imported prices was driven by higher global oil prices and resulted in an increase in petrol and diesel prices over the month by 4.5% and 2.9%, respectively. The lower domestic prices can be attributed mostly to a decline in the prices of local tobacco such as Palataisi cigarettes, and also the local produce mainly root crops and vegetables such as kumara, taro, cassava, yams, lu, cabbage and carrots.

The annual headline inflation still remained below the 5% reference rate in May, at 1.6% compared to 3.8% in the same month last year. Both domestic and imported prices rose over the year to May 2019 by 1.5% and 1.7% respectively. Domestic inflation contributed 0.7% to the annual headline inflation as higher prices were noted for tobacco, food, and restaurant services. Imported inflation contributed 0.9% to the annual headline inflation due to higher prices of imported tobacco, alcohol, and fuel.

Table 2: Items contributing to annual domestic inflation

Items (\$ per kg)	Monthly			Annual	
	May-19	Apr-19	Change	May-18	Change
Cassava	\$1.12	\$1.22	-\$0.10	\$0.77	\$0.35
Cockles (to'o)	\$5.21	\$4.79	\$0.42	\$5.06	\$0.15
Talo-Futuna	\$1.49	\$1.73	-\$0.24	\$1.47	\$0.02
Talo-Tonga	\$1.65	\$1.70	-\$0.05	\$1.65	\$0.00
Kumala	\$1.88	\$2.12	-\$0.24	\$1.92	-\$0.04
Sausages	\$8.19	\$8.26	-\$0.07	\$8.33	-\$0.14
H/cabbage	\$3.09	\$3.74	-\$0.65	\$3.45	-\$0.36
Octobus	\$17.64	\$17.20	\$0.44	\$18.61	-\$0.97
Lu	\$3.58	\$4.00	-\$0.42	\$4.64	-\$1.06
Yams-early	\$3.58	\$3.90	-\$0.32	\$4.86	-\$1.28
Carrots	\$3.29	\$3.40	-\$0.11	\$6.18	-\$2.89

Source: Statistics Department

Domestic inflation contributed 0.7% to the annual headline inflation as higher prices were noted for tobacco, food, and restaurant services. Imported inflation contributed 0.9% to the annual headline inflation due to higher prices of imported tobacco, alcohol, and fuel.

### Exchange rates remained competitive

Table 3: Exchange Rates

	Monthly			Annual	
	May-19	Apr-19	% Growth	May-18	% Growth
Nominal Effective Exchange Rate Index	92.4	92.0	0.4	90.5	2.1
Real Effective Exchange Rate Index	106.8	105.7	1.0	104.7	2.0

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) index slightly increased over the month due to the depreciation of the AUD, NZD, FJD, GBP & CNY against the TOP. The Real Effective Exchange Rate (REER) also rose during the month as Tonga's inflation rate increased in May 2019. Annually, both the REER and NEER rose, which may impact the international competitiveness of exported goods and services.

Table 4: Bilateral Exchange Rates

	May-19	Apr-19	May-18
USD/TOP	0.4353	0.4396	0.4474
AUD/TOP	0.6300	0.6228	0.5907
NZD/TOP	0.6689	0.6592	0.6404
FJD/TOP	0.9445	0.9413	0.9332
JPY/TOP	47.6849	49.0967	48.7286
GBP/TOP	0.3451	0.3398	0.3370
EUR/TOP	0.3909	0.3930	0.3840
CNY/TOP	3.0044	2.9601	2.8719

Source: National Reserve Bank of Tonga

Annually, both the REER and NEER rose, which may impact the international competitiveness of exported goods and services.

However, the gap between the NEER and REER are narrowing compared to previous months due to Tonga's inflation falling lower than most of its major trading partners.

### Higher receipts improved the overall balance

Table 5: Foreign Reserves

	Monthly			Annual	
	May-19	Apr-19	% Growth	May-18	% Growth
Foreign Reserves (\$ in million)	468.3	464.2	0.9	441.9	6.0
Import Coverage (months)	7.9	7.8		7.8	

Source: National Reserve Bank Tonga

Foreign reserves increased in May 2019 by \$4.1 million and over the year by \$26.4 million to \$468.3 million, equivalent to 7.9 months of imports cover. Receipts of government grants and budget support drove the higher foreign reserves.

Table 6: Overseas Exchange Transactions  
Overseas Exchange Transactions

	Monthly			Annual		
	May-19	Apr-19	% Growth	May-19	May-18	% Growth
Overall Balance	4.1	-0.8	-640.9	26.4	49.6	-46.8
Current Account	5.1	-0.8	-768.6	5.3	4.2	24.5
Merchandise Trade	-36.3	-31.5	15.5	-424.2	-388.9	9.1
Services	0.3	6.6	-95.4	26.1	39.1	-33.3
Income	2.5	1.3	101.9	10.2	-11.3	-189.6
Transfers	38.6	22.8	69.0	36.5	41.7	-12.6
Capital Account	4.7	2.7	76.1	34.4	43.3	-20.6
Financial Account	-5.7	-2.7	112.6	-15.3	3.7	-515.8

Source: Banking Systems

In May 2019, the overall balance recorded a surplus compared to a deficit in the past three months. This was due to higher receipts (mainly in the current account), rising by \$15.1 million to a total of \$76.6 million. Total transfer receipts rose the most by \$16.1 million to \$44.7 million, led by a \$6.8 million rise in private transfers which are mostly remittance receipts reflecting the celebration of White Sunday, Mother's Day and Father's Day in May. Official transfers rose by \$5.8 million which are mostly grants for government projects and budget support. Transfer receipts by non-profit organizations also rose by \$3.4 million which are mostly receipts by local Churches. Travel receipts also rose by \$3.5 million coinciding with the rising number of passenger arrivals. Both official and private capital receipts also rose by \$1.5 million.

Nonetheless, total payments also increased over the month mainly driven by payments for imported goods \$5.1 million, services \$6.7 million, and direct investments abroad \$3.1 million.

Annually, the OET balance surplus lowered due to higher outflows from the current and financial accounts. Higher payments were noted for goods & services and interbank transfers. These outflows outpaced the rise in receipts from travel, official and private transfers including remittances, and export proceeds.

### Broad money fell on lower net domestic assets

Higher credit to private sectors over the month lowered the net domestic assets as well as broad money, despite the increase in net foreign assets. However, in annual terms, broad money continued to rise in line with the higher foreign reserves from receipts of budgetary support,

grants, and cyclone relief funds from development partners and remittances.

Table 7: Broad Money

	Monthly			Annual	
	May-19	Apr-19	% Growth	May-18	% Growth
Broad money (\$ in million)	584.8	585.9	-0.2	561.5	4.2
Net Foreign Asset	488.8	482.6	1.3	460.4	6.2
Net Domestic Asset	96.4	103.7	-7.1	101.3	-4.9

Source: Banking System, National Reserve Bank of Tonga

### Liquidity remained high

Table 8: Reserve money

	Monthly			Annual	
	May-19	Apr-19	% Growth	May-18	% Growth
Reserve money (\$ in million)	311.0	305.9	1.7	298.4	4.2

Source: Banking System, National Reserve Bank of Tonga

Liquidity in the banking system increased over the month and year to May 2019 by \$5.1 million and \$12.6 million respectively to \$311.0 million. This was due mainly to higher Banks' exchange settlement accounts (ESA). Currency in circulation also rose and supported the monthly movements while increased required reserve drove the annual rise.

The banks' total loans to deposit ratio increased from 77.5% to 78.7% over the month, reflecting higher loans against declining deposits.

### Credit rebounds to a new high level

Table 9: Total Lending

Lending	Monthly			Annual	
	May-19	Apr-19	% Growth	May-18	% Growth
Total Lending (\$ in million)	487.3	484.3	0.6	448.2	8.7
Business lending	227.9	225.1	1.2	202.7	12.4
Household lending	259.1	258.9	0.1	245.9	5.4
Other lending	0.3	0.3	9.8	0.9	-64.5

Source: Banking System, National Reserve Bank of Tonga

Following a decline last month, the total banks' lending grew to a new high level of \$487.3 million in May 2019. This was due mainly to higher lending to businesses mainly for the distribution, agriculture, and professional & other service sectors, supported by the continuous increase in housing loans by households. Over the year, the total lending increased by \$39.0 million (8.7%) which is again underpinned by higher businesses and individual loans such as lending to public enterprises, transport, professional & other services, and distribution sectors as well as households housing and personal loans.

### Weighted average interest rate spread continued narrowing

Table 10: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	May-19	Apr-19	Growth (bps)	May-18	Growth (bps)
Weighted Average Banks Deposit Rate (%)	1.956	1.954	0.2	2.078	-12.2
Weighted Average Banks Lending Rate (%)	8.044	8.111	-6.7	7.985	5.9
Weighted Average Interest Rate Spread (%)	6.088	6.157	-6.9	5.907	18.1

Source: Banking System, National Reserve Bank of Tonga

The weighted average interest rate spread narrowed over the month by 6.9 basis points to 6.09%. This was a result of the continuous decline in weighted average lending rates offsetting the slight rise in weighted average deposit rates. Lower lending rates were mainly for the manufacturing, construction and agricultural sectors, and also household housing and other personal loans. The slight rise in deposit rates was due to the increase in the



# NATIONAL RESERVE BANK OF TONGA

## MONTHLY ECONOMIC REVIEW

Vol. 6

No. 5

Month Ended: May 2019

---

volume of savings deposit despite the declining deposit rates offered.

Over the year, the weighted average interest rates spread continued to widen by 18.1 basis points due to the continuous rise in the weighted average lending rates while the weighted average deposit rates declined. The increase in lending rates were mostly for the professional & other services, manufacturing, and distributions sectors as well as household vehicle loans, whereas lower deposit rates were for demand and time deposit rates.

### Outlook

The Reserve Bank expects domestic economic activity to remain positive in the medium term. Furthermore, the foreign reserves is expected to remain at comfortable levels and inflation to continue remaining below the Reserve Bank's inflation reference rate of 5% per annum throughout 2019. The Reserve Bank will continue to closely monitor developments in the domestic and global economies to ensure financial and macroeconomic stability are maintained.