

Inflation

Release date: 16 November 2016

September 2016

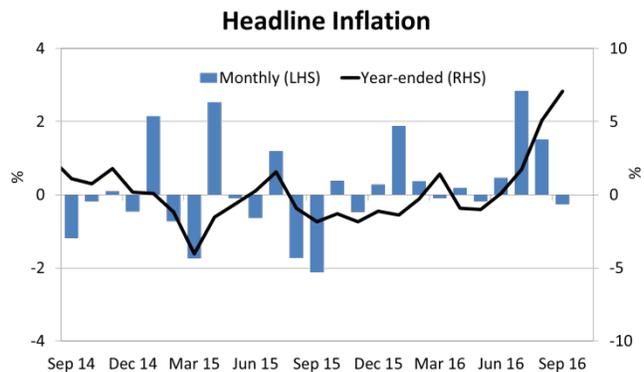
| | Sept 16 | Aug 16 | Jul 16 | Jun 16 |
|------------------|------------|------------|------------|------------|
| Headline* | 7.0 | 5.1 | 1.6 | 0.1 |
| Domestic^ | 4.3 | 2.1 | 0.7 | 2.1 |
| Imported^ | 2.8 | 3.1 | 1.0 | -1.9 |

*Year-ended growth

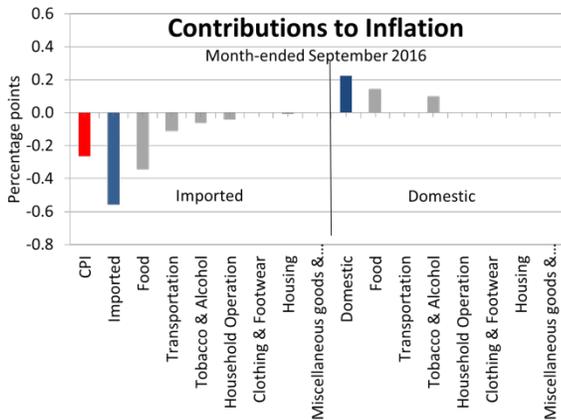
^Percentage point contribution to year-ended growth

New duties driving higher annual inflation rate

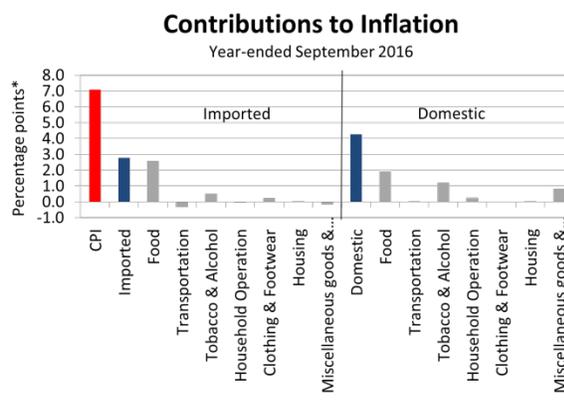
Annual inflation rose by 7.0%. The significant rise stems from the new customs duties on imported food products as well as domestic prices being at very low levels last year. However, over the month of September 2016, the monthly headline inflation rate fell by 0.3%. The fall in imported prices was more than enough to offset the rise in domestic prices. This was mainly driven by the prices of imported food and transportation, which fell by 1.2% and 1.1% respectively over the month.



Source: Statistics Department

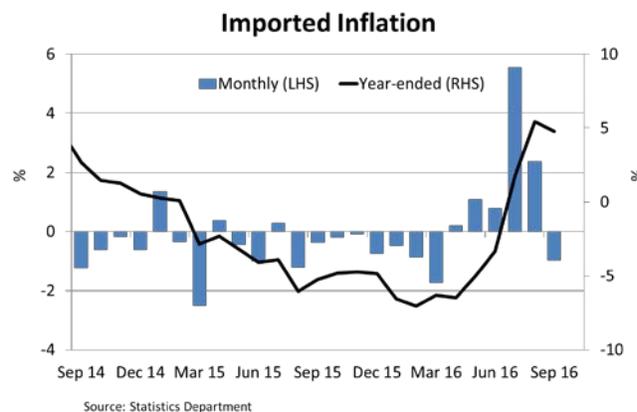


Source: Tonga Department of Statistics



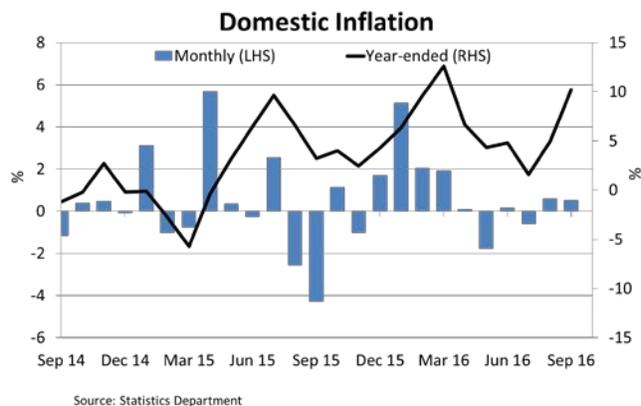
Source: Tonga Department of Statistics

The monthly imported inflation fell by 1%, however annually, it rose by 4.7%. The high annual imported prices reflect the new customs duties effective on 1st July 2016. The recently released World Economic Outlook (WEO) has attributed world food prices to the effects of El Nino on international food markets to slowly increase. World oil prices are on the rise due to disruptions in production. This comes after world oil prices reached a 10 year low in January 2016. The flow on effects of changes in world oil prices is felt in Tonga with a lag of between 1-2 months.



Source: Statistics Department

The monthly domestic inflation rose by 0.6% in September and by 10.2% annually. The significant rise in annual domestic inflation, stems from domestic inflation being at very low levels last year. A year ago, world food and oil prices were on the decline. September 2015 was when the pass through of world prices onto the domestic prices was most evident. With imported goods such as food being cheaper, *ceteris paribus*, the prices in



the domestic market had to adjust lower as well in order to compete. The prices of Kava powder still remains on the rise at around 170% more than in December 2015.

Annual Underlying inflation which excludes imported food and transportation rose by 10.1%. The rise in underlying inflation, stems from a significant rise in prices of imported cigarettes and domestic kava. Imported cigarettes are also included in the new excise tax introduced in July and the prices of kava powder has been increasing since November last year due to the shortage of supply following bad weather conditions over the year.

Kava prices are likely to be on the rise for some time due to a shortage of supply and will contribute to driving domestic inflation. In the lead up to summer which is usually dry, the lack of rainfall will affect the supply of domestically grown fruits and vegetables and thereby drive prices up. With world oil and food prices slowly on the rise; together with the added new customs duty, this will impact imported inflation and drive headline inflation up. The annual headline inflation rate is therefore expected to be around 6.7% in October 2016, and remain within the NRBT's reference range of 6-8% until December 2016 before gradually slowing out of the set range.

Inflation Breakdown*

| | Weight % | Month-ended Change % | Contribution to total ppt | Year-ended Change % | Contribution to total ppt |
|---|-------------|----------------------------|---------------------------------|---------------------------|---------------------------------|
| CPI | 100 | -0.3 | -0.3 | 7.1 | 7.1 |
| Domestic | 42.2 | 0.5 | 0.2 | 10.2 | 4.3 |
| Food | 17.8 | 0.7 | 0.1 | 10.1 | 1.9 |
| <i>Fruit & vegetables</i> | 6.5 | -5.7 | -0.5 | 13.1 | 1.0 |
| <i>Meats, fish & poultry</i> | 3.7 | 5.1 | 0.2 | 9.7 | 0.4 |
| <i>Dairy farm & vegetable products</i> | 0.5 | 0.0 | 0.0 | 3.0 | 0.0 |
| <i>Cereals & cereal products</i> | 3.4 | 14.5 | 0.5 | 14.6 | 0.5 |
| <i>Other food</i> | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| <i>Drinks, sweets and meal away from home</i> | 3.7 | 0.0 | 0.0 | 1.0 | 0.0 |
| Transportation | 0.5 | 0.0 | 0.0 | 0.5 | 0.0 |
| Tobacco & Alcohol | 1.5 | 4.2 | 0.1 | 84.9 | 1.2 |
| <i>Tobacco</i> | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| <i>Alcohol</i> | 0.8 | 5.4 | 0.0 | 15.7 | 0.1 |
| <i>Kava</i> | 0.7 | 3.6 | 0.1 | 164.8 | 1.1 |
| Household Operation | 17.3 | 0.0 | 0.0 | 1.5 | 0.2 |
| Clothing & Footwear | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Housing | 1.7 | 0.0 | 0.0 | 2.4 | 0.0 |
| Miscellaneous goods & services | 3.5 | 0.0 | 0.0 | 24.9 | 0.8 |
| Imported | 57.8 | -1.0 | -0.6 | 4.8 | 2.8 |
| Food | 27.9 | -1.2 | -0.3 | 9.2 | 2.6 |
| <i>Fruit & vegetables</i> | 0.9 | 0.6 | 0.0 | -7.3 | -0.1 |
| <i>Meats, fish & poultry</i> | 14.6 | -2.3 | -0.4 | 16.2 | 2.4 |
| <i>Dairy farm & vegetable products</i> | 3.2 | 0.1 | 0.0 | -0.3 | 0.0 |
| <i>Cereals & cereal products</i> | 3.5 | 1.3 | 0.0 | 3.1 | 0.1 |
| <i>Other food</i> | 5.7 | -0.1 | 0.0 | 3.2 | 0.2 |
| <i>Drinks, sweets and meal away from home</i> | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Transportation | 11.5 | -1.1 | -0.1 | -3.0 | -0.3 |
| <i>Private</i> | 8.6 | -1.6 | -0.1 | -4.1 | -0.3 |
| <i>Public</i> | 2.9 | 0.0 | 0.0 | 0.0 | 0.0 |
| Tobacco & Alcohol | 4.5 | -1.3 | -0.1 | 10.8 | 0.5 |
| <i>Tobacco</i> | 2.9 | 0.0 | 0.0 | 18.2 | 0.6 |
| <i>Alcohol</i> | 1.6 | -4.2 | -0.1 | -4.2 | -0.1 |
| <i>Kava</i> | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Household Operation | 3.5 | -1.5 | 0.0 | -1.7 | -0.1 |
| Clothing & Footwear | 3.2 | 0.0 | 0.0 | 5.5 | 0.2 |
| Housing | 0.8 | -1.3 | 0.0 | 0.7 | 0.0 |
| Miscellaneous goods & services | 6.4 | 0.0 | 0.0 | -2.5 | -0.2 |
| Underlying CPI measures | | | | | |
| Ex. Energy | 81.4 | -0.2 | -0.2 | 9.8 | 8.1 |
| Ex. imported food | 72.1 | 0.0 | 0.0 | 6.2 | 4.4 |
| Ex. energy and imported food | 53.5 | 0.3 | 0.2 | 10.1 | 5.5 |

* Due to rounding errors some data may not aggregate precisely.

Source: Tonga Department of Statistics