

# Monthly Economic Review

## June 2014

The global economy is growing at a moderate pace, supported by firm conditions in advance economies. The Reserve Bank of New Zealand (RBNZ) raised official interest rates in July; citing raising inflationary pressures due to strong output growth. The Australian unemployment rate jumped to a 12 year high of 6.4 per cent in July, highlighting that economic fragility continues. US growth expectations were downgraded 0.6 percentage points to 1.6 per cent for 2014, following weaker than anticipated activity during the country's harsh winter. Conditions in the euro area appear stable, with only marginal improvements. Consensus outlook for China remains stable at 7.3 per cent for 2014.

Indicators of domestic activity were mixed but overall, broadly positive. Building applications rose 17 per cent in June, flagging a boost to near-term construction activity, supported by a rise in lending and new commitments for private construction. The National Reserve Bank of Tonga (NRBT) anticipates the sector's momentum to continue as scheduled public works and the Ha'apai reconstruction comes online. Partial indicators show strong growth among the distribution sector with rises in container and vehicle registrations. Container registrations recorded a 90 per cent increase over June, partly boosted by preparations for the King's Birthday celebrations and church conferences.

Despite the festivities, provisional data indicated a decline in international arrivals. Following a strong result in May agricultural exports dipped in June, while still strong over the year suggesting modest growth for the sector. Electricity production and consumption were down over June, signalling softer business activity.

Tonga's headline inflation declined 1.5 per cent in the month of June. In year-ended terms, prices rose just 1.5 per cent, down from 4.7 per cent in March. June's easing inflationary pressures were largely driven by a decline in domestic fruit & vegetable prices, notably reflecting stronger supplies of tomato, head cabbage and carrot. The imported inflation component also fell in June due mainly to declines in prices of household fuel & power, and meat, fish & poultry. Most imported food is sourced from New Zealand, where exchange rates have recently played a significant role in raising prices. The RBNZ believes the value of the New Zealand dollar is unjustified and unsustainable, citing the potential for a significant fall.

The Nominal Effective Exchange Rate (NEER) index fell 0.3 per cent in June, implying a depreciation of the pa'anga against its major trading partners. The Real Effective Exchange Rate (REER) fell 2.1 per cent reflecting a boost to Tonga's international competitiveness. Over the



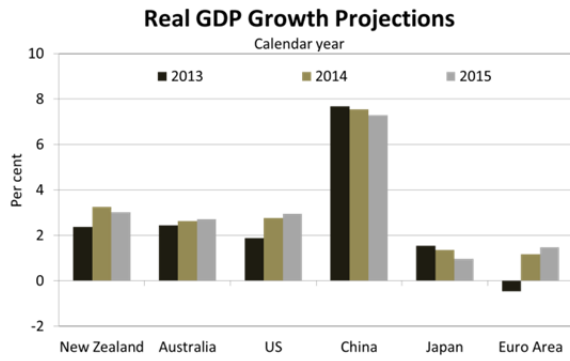
year, both the NEER and REER index fell 3.6 per cent and 4.1 per cent, respectively.

Tonga's trade deficit narrowed to around T\$245.9 million over the year to June. This was driven by a decline in import payments, particularly oil, being offset by a rise in agricultural and marine export receipts. Over the month of June, remittances fell by 9.0 per cent. Foreign reserves are currently around T\$274.4 million, covering 8.9 months of imports. The past nine months' of imports data have been revised down, consistent with official trade data.

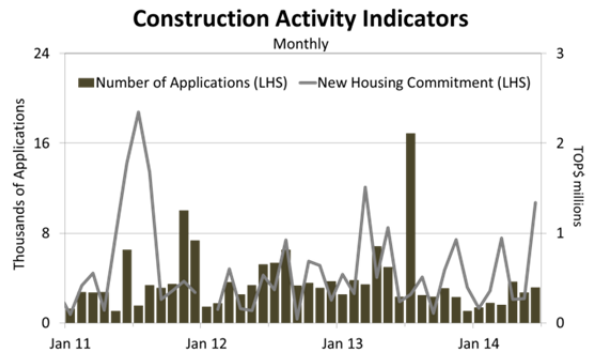
Growth in broad money increased to 3.0 per cent in June, up from 0.2 per cent in May. This reflected a rise in net foreign assets and firmer bank lending, supported by a stronger households sector. Banking system liquidity declined by 2 per cent over the month, owing in part to a large transfer by the airline sector. However, the gross loans-to-deposit ratio remains below the 80 per cent trigger level, indicating an adequate liquidity margin for prudent lending. Household commitments rose over the month, mainly due to an increase in the housing and transport sectors. The rise in transport coincides with an increase in import payments for vehicles. New commitments for businesses also increased, particularly in the distribution sector. As the rate of non-performing loans declines, banks are continuing to ease their portfolio consolidation. This is enabling further growth for new and viable commercial projects. While deposit rates remained steady, lending rates eased in June, producing the narrowest interest rate spread since at least February 2012.

The lower lending rates reflect major banks' competition to retain performing customers through refinancing, together with excess liquidity in the market. The Government of Tonga received budget support of around T\$8 million. This contributes to the increase in foreign reserves during the month of June. In July, T\$5 million of government bonds were sold at 3 per cent interest for a 5 year term. The next bond issue is expected in late August for maturing bonds rollover; this would have no impact on liquidity or government deposits. The Chinese loan principal repayments have been deferred.

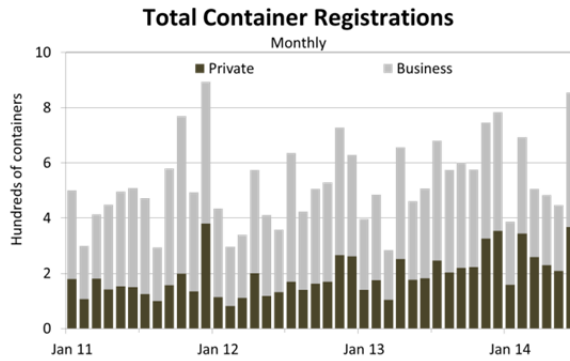
Given stability among major trading partners' economies, the NRBT remains cautiously optimistic about an economic recovery in Tonga. Early signs of improvement are evident with the construction and distribution sectors poised to lead growth. We expect this to be supported by robust credit growth as business confidence and conditions improve. Some trade-exposed sectors may face challenges from a possible depreciation of the New Zealand dollar, while other businesses and consumers would enjoy lower import prices. Low inflationary and liquidity pressures together with ample foreign reserves provide no requirement to adjust monetary policy settings in the near-term.



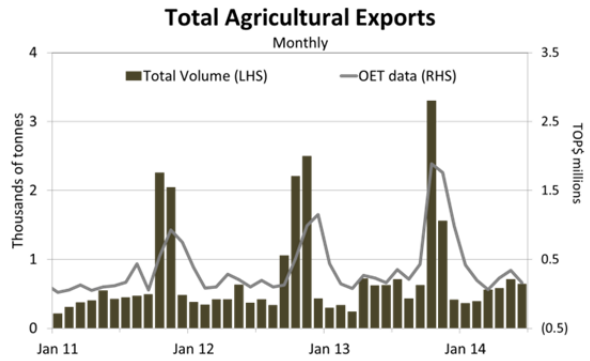
Source: IMF (World Economic Outlook, April 2014)



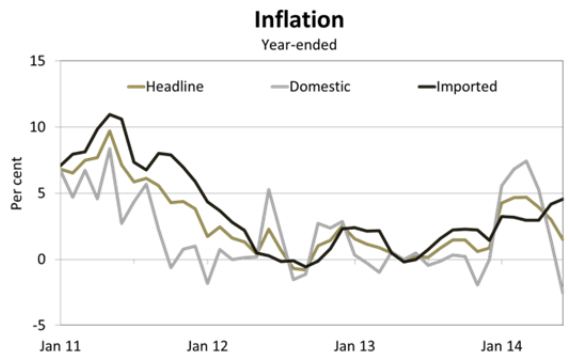
Source: Ministry of Infrastructure; Banking System



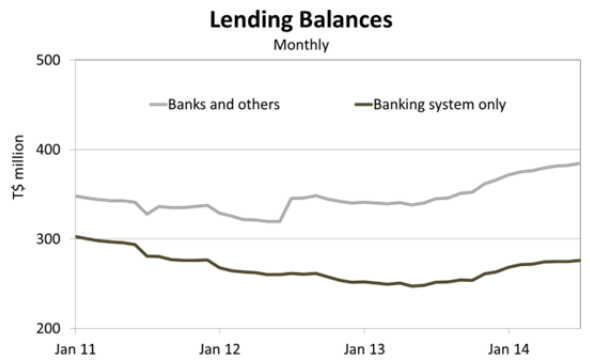
Sources: NRBT, Statistics Department, Tonga Ports Authority



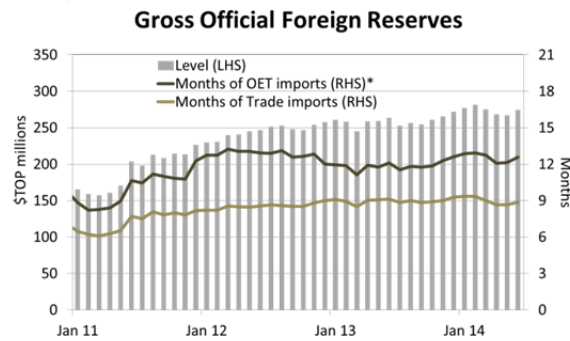
Source: NRBT; Ministry of Agriculture, Forestry, Food and Fisheries



Source: Department of Statistics



Sources: Banking System; SPBD; RFB; Government of Tonga



\* Break in January 2012 due to introduction of foreign exchange dealer reporting.  
Sources: banking system; foreign exchange dealers; NRBT

