

Monthly Economic Review

October 2014

Developments among the region's advanced economies are showing mixed, but broadly positive signs for Tonga's recovery. A depreciation in the New Zealand dollar over September may exert some pressure on Tonga's export industries, while easing imported inflation. Developments in Australia and the United States are broadly positive, yet the respective central banks do not anticipate a change in interest rates for some time to come. Fiji continues to grow solidly, with the Reserve Bank of Fiji expecting a fifth year of expansion over calendar year 2014. Weak inflation in July reaffirms continued challenges in the euro zone, while conditions in Japan continue to recover moderately in trend terms. Consensus forecast for economic growth in China remains at 7.4 per cent for 2014.

Domestically, on balance, the economy grew slightly amid mixed results from partial indicators of domestic activity. We expect that hotels and restaurants' activity was adversely affected by a decline of 13.2 per cent in international arrivals over the month. However, results were still 1.2 per cent higher than August 2013. Domestic air traffic also recorded a fall of 3.2 per cent likely reflecting the seasonality of the tourist season and a stronger July partly due to church conferences held in the outer islands. Trade activity, however, is expected to remain strong due to an increase of 9.3 per cent in container registrations driven by a

rise in private containers which was offset slightly by a fall in business containers. Much of the growth is expected to be generated by the less formal parts of the sector such as the 'Saturday Fairs'. Financial sector activity also showed strength over the month. While liaison suggests that agricultural activities fared well during August, it also indicates that fishing activities declined, partly due to unfavourable weather conditions. Data from one of the few major fishing companies also showed a decline in catch rate for the month.

Headline inflation rose moderately in August 2014, due to the imported component. In year-ended terms, prices rose by 2.5 per cent, up from 1.9 per cent in July. This result was almost entirely due to a rise in imported food prices, particularly meats, fish & poultry. Major contributor to recent imported inflation is the strong New Zealand dollar, although it slightly depreciated relative to the pa'anga, over August. Domestic components also increased over the month, due mainly to increases in prices of meat, fish & poultry. The Reserve Bank of New Zealand anticipates further depreciation of the New Zealand dollar, which may ease Tonga's imported inflationary pressures.

The movement of the pa'anga against a basket of currencies to which it is pegged against remained unchanged in August. Both the Nominal Effective Exchange Rate

(NEER) and Real Effective Exchange Rate (REER) remained unchanged. Over the year, both the NEER and REER index fell 2.5 per cent and 2.7 per cent, respectively though slightly higher than in previous year.

Tonga's overall foreign exchange transactions balance was in surplus over the month of August, although lower than the surplus in July. The net current account outflows were more than offset by a combination of higher capital and unclassified inflows. The monthly import payments for merchandise goods declined in August, particularly for oil and construction materials. The monthly exports receipts rose, with marine and fisheries exports performing better than agricultural exports. Travel receipts were lower than in July, this was anticipated as August is not a festive month. Travel receipts are expected to pick up in the next two months as Christmas approaches. Remittances rose by 0.3 per cent, with increases from Australian and US sources experiencing positive growth. This was more than enough to offset a decline from New Zealand. Foreign reserves rose to T\$283.9 million in August, covering 9.0 months of imports, well above the NRBT's reference range.

Broad money rose by 0.9 per cent to T\$367.8 million in August, reflecting a rise in other deposits and currency in circulation offsetting a decline in transferrable deposits. Banking system liquidity rose by 9.0 per cent over the month, underpinned by the rise in foreign reserves. An adequate liquidity margin for prudent lending remains, particularly in

short term deposits. Bank lending rose by \$1.4 million equivalent to 0.5 per cent credit growth over the month. The increase was driven by growth in some key sectors particularly wholesale and retail, agriculture, tourism and manufacturing. Other personal loans continued to grow indicating the continuous demand for funds by individuals.

In year ended terms, total bank lending balances rose by 9.4 per cent (\$24 million), mainly due to increased lending to public enterprises. Including loans extended by non-banks, the lending balance increased by 10.6 per cent over the year. Deposit rates increase slightly, particularly demand deposits reflecting a fall in demand deposits volume. Lending rates continue to fall slightly in August. The fall creates a response in business investment activity and consumer borrowing, evident by rise in new commitments to housing, manufacturing, agriculture and especially construction. Increases to constructions reflect the commencement of the Ha'apai housing reconstruction. August records the narrowest interest rate spread of 6.7 per cent since at least February 2012.

Contributing to the rise in broad money, net credit to government rose by 12.9 per cent in August 2014. This follows a decline in deposits more than offsetting a decline in bonds held by banks, reflecting the pay out of maturing bonds and servicing overseas loan repayments. The decline in total government bonds held by banks contributes to the increase in banking system liquidity over the month.

Supported by stable conditions overseas, the NRBT remains cautiously optimistic for a continued domestic recovery. This is despite some softer conditions over August, mostly reflecting seasonality. Bank lending among all sectors maintains strength as interest rate spreads continue to narrow. In line with banking system liquidity, foreign reserves continue growing and remain well above the statutory benchmark. Inflation remains well within acceptable levels, as the pa'anga strengthens against key import currencies. Given this, the NRBT expects to maintain the existing monetary policy setting.



