

Monthly Economic Review

For September 2015

International developments amongst Tonga's key trading partners continued to support domestic economic activity. Unemployment in the United States, Australia and New Zealand remained steady. World oil prices continued to fall over the month by 3.7% to about US\$48 per barrel. However, the Tongan Pa'anga depreciated against the New Zealand Dollar, the Australian Dollar, and the U.S. Dollar.

Domestic economic activities continue to support the National Reserve Bank of Tonga's forecast for domestic growth. Economic activities picked up over the month of September 2015. Liaison meetings with agricultural growers indicate that the recently improved weather conditions supported an increase of agricultural exports. Specifically, volumes increased by 37.9% as a result of more squash, coconut, and cassava products. Additionally, it is currently squash exporting season which could explain the rise. This further coincides with monthly movements over previous years. However, agricultural exports receipts decreased possibly due to a delay in receiving proceeds. The trade sector recorded higher number of container registrations which rose by 24.1%. This coincided with payments for imports (excluding oil) which increased by 35.0% over the month. Vehicle registrations rose by 8.2% due to more registrations for 'Taxis & Rentals', 'Light vehicles', and 'Cars'. Furthermore, air arrivals increased by 9.1% and was supported by a 1.6% rise in travel receipts.

Inflation decreased by 2.1% over September as a result of declines in both imported and domestic prices. Domestic inflation fell by 4.3% due to lower prices within the Food and Household Operation components. Food items such as pawpaw, watermelon, pele, and tomatoes contributed to the decrease. This could be due to better weather conditions which is supported by the rainfall data showing an increase over the month. Suckling pigs, tuna, and other seafood drove domestic food prices down further. Imported inflation decreased

slightly by 0.4% due to a fall in Transportation prices. This had offset minimal increases in Imported Food, Housing, and Tobacco & Alcohol prices. The weaker Tongan Pa'anga could have slightly offset the effect of falling global prices for oil and food.

Annual headline inflation declined by 1.9%, driven by imported prices which decreased by 5.2%. In particular, prices for almost all imported food items contributed largely to the decline. World oil prices dropped over the year which affected the Transportation and electricity prices (Household Operations). Other imported items such as Tobacco & Alcohol, and Clothing & Footwear prices increased over the year but were insufficient to offset the declines in food and energy prices. Domestic inflation rose by 3.2% as a result of higher food prices, particularly Fruit & Vegetables. This coincides with lower agricultural output over the year due to adverse weather conditions.

The Nominal Effective Exchange Rate (NEER) and the Real Effective Exchange Rate (REER) both declined over the month of September 2015 by 1.3% and 3.4% respectively due mainly to the general depreciation of the Tongan Pa'anga against currencies of its major trading partners and Tonga's lower inflation. This indicates an improvement in Tonga's price competitiveness against that of its major trading partners.

Total Overseas Exchange Transactions (OET) Payments rose by 30.5% over the month of September to \$57.5 million. This was due to a 31.4% rise in current account payments. A \$4.4 million increase in payments for interest on external loans also contributed to the rise. The increase in current account payments was mainly driven by a \$7.1 million increase in import payments, particularly for wholesale & retail goods. The recent opening of Adiloo Store and Spare-Parts Zone (Tonga) Ltd in Tongatapu

support this movement. This is the highest monthly import payments since November 2007.

Total OET Receipts slightly declined by 1.0% over the month to \$54.6 million. A fall in transfer receipts to private and non-profit organisations more than offset a significant increase in official transfers over the month. The rise in official transfers reflect the receipt of more than \$8 million government budget support from the European Union. The fall in the financial account receipts due to lower interbank transfers with its overseas correspondent banks offset a rise in total export proceeds particularly from marine products and services receipts over the month. Total remittances also fell by 14.7% over the month.

The balance of OET which is the net change to gross foreign reserves over the month of September recorded a surplus of \$0.9 million, which is \$7.5 million lower than that in the previous month. The lower surplus reflected a net current account deficit of \$8.8 million relative to a \$3.1 million surplus recorded in August. Gross foreign reserves reached a new record high of \$311.7 million at the end of September, which is equivalent to 8.8 months of import cover, well above the NRBT's minimum range of 3-4 months.

Broad money fell slightly over the month of September by 0.4%, resulting from a 0.8% decline in net foreign assets, offsetting a 0.2% increase in net domestic assets. The decline in net foreign assets resulted from a fall in deposits abroad while an increase in domestic credit drove the growth in net domestic assets. Currency in circulation fell over the month due to recall of old currencies contributing to the fall in broad money. However, broad money rose by 13.2% in year ended terms, driven by increases in foreign reserves and domestic credit. Total domestic demand deposits and currency in circulation also increased over the same period. Furthermore, banking system liquidity slightly declined over the month but still remained high by the standard of the past year.

Bank lending increased over the month by 1.8%, driven by increases in all the categories, particularly business lending. Including loans extended by non-banks, total lending only rose by 1.3% due to lower on-lent loans by the government. At the same time, more than 60 new

loans were approved from the Government's managed funds scheme during the month, totalling to more than \$0.4 million. In year ended terms, total bank lending increased by 14.0%, underpinned by the increases in lending to businesses and households. This is the highest growth recorded since October 2008. Including loans extended by non-banks, total lending recorded similar growth to that offered by the banks, with household the main driver.

Weighted average interest rate spread changed little over the month from 5.99% to 5.98% in September 2015. Both weighted average lending and deposit rate rose at a similar rate.

Net credit to government fell by around 4.0% due to a 2.8% rise in government deposits at the end of September. While both government receipts and payments grew strongly over the month, the government receipt of over \$10 million from donor partner, more than offset the government's external debt payments.

Supported by developments among Tonga's key trading partners, the NRBT's outlook for a broadly positive domestic growth remains. Economic activities picked up over the month of September 2015. Annual headline inflation is expected to remain within the target range in the near term largely due to expectation of lower world oil prices. We also expect robust credit growth as business confidence and conditions improve. The banking system continued to remain relatively stable and profitable, with reported credit growth and strong liquidity and capital position. Low liquidity pressure together with ample foreign reserves provide no requirement to adjust monetary policy settings in the near-term.

The NRBT will continue to promote prudent lending, closely monitor credit growth and be mindful of the impact of a continued deflation. The NRBT will closely monitor the country's economic developments and financial conditions to maintain internal and external monetary stability, promote financial stability and a sound and efficient financial system to support macroeconomic stability and economic growth.

