



MONTHLY ECONOMIC REVIEW

Vol. 3

No. 12

Month Ended: December 2016

Developments amongst Tonga’s major trading partners in December 2016 continued to support domestic economic activity. The U.S. economy recorded softer GDP growth of 1.9% over the December quarter from 3.2% in the previous quarter, due mainly to lower shipments of soybeans weighing on exports. Inflation however rose by 2.1% in December 2016 which supported the U.S. Federal Reserve Bank’s decision to raise the official interest rate by 0.25% to a range of 0.50% – 0.75%. Contrastingly, Australia’s economy recorded its biggest trade surplus on record of AUD\$3.5 billion as a result of surging commodity prices. Despite the slight increase in unemployment in Australia to 5.8% from 5.7% in the previous month, inflation rose by 1.5% over the month which supported the Reserve Bank of Australia’s (RBA) decision to leave the official interest rates at 1.5%. The unemployment rate increased slightly in New Zealand (NZ) to 5.2% from 4.9% in the previous quarter. Similar to the U.S. and Australia, higher fuel and housing prices largely contributed to inflation rising by 1.3% in December 2016, which is within the RBNZ’s inflation target band of 1-3%.

During the month of December 2016, overall domestic economic activities continued to support the NRBT’s expectation of stronger growth for 2016/17. The performance of all sectors was favourable except for the agricultural sector recording lower export volume, similar to December last year. Agricultural exports fell by 9.1% (58.2 tonnes) during the month but over the year it has increased by 11.2% (798 tonnes). Similar to previous years, exports in December have always been slightly lower than November, due to expectations that the domestic agricultural production is stronger in December to meet the high demand during the festive Christmas season. However, growth in the secondary sector was seen in business loans for manufacturing increasing by \$0.1 million (0.8%) over the month and \$0.8 million (18.3%) over the year, and housing loans increasing over the month by \$2.7 million (1.8%). Additionally, consumption and production of electricity have increased in December 2016 by 0.2 million kilowatts and 0.3 million kilowatts respectively which is in line with the rise in the number of consumers by 87 households. The increased usage of air conditioning due to the hot summer weather may have also contributed to the higher consumption of electricity.

The services sector was generally positive over the month. International arrivals reached a new record high in December 2016 with a total of 16,324 passengers. Air

visitors contributed the most with 8,108 visitors, as people travelled for vacation and during the Christmas holidays. This was followed by cruise ship arrivals with 5,155 visitors as 4 large cruise ships arrived during the month. Costa Atlantica brought the first ever Chinese tourists of around 2,000 passengers in December, following the introduction of the mutual visa exemption between Tonga and China in June 2016. Additionally, containers registered in December 2016 increased by 168 containers (15.4%) largely led by a 167 (34.2%) increase in private containers. This continued to reflect stronger economic activity, coinciding with the higher imports, and also indicated a rise in the informal distribution sector (flea market). Vehicle registrations rose by 92 vehicles (28.2%), this was mostly due to an increase in individual vehicle registrations with cars increasing by 43 registrations followed by other light vehicles with 34 registrations. Moreover, business loans for transportation increased by \$0.9 million (40.4%) over the month.

The total number of job advertisements continued to fall by 10 vacancies over December 2016 however rose over the year by 13 vacancies, led by recruitment intentions in all the sectors except for services sector. This indicates a rising demand for labour in Tonga and may assist in reducing the unemployment rate.

Prices	Monthly		Annual	
	Dec-16	Nov-16	Dec-16	Nov-16
Headline Inflation (%)	0.3	0.1	6.7	6.8
Domestic prices	0.1	-0.1	6.4	8.1
Imported prices	0.3	0.2	6.9	5.8

Higher imported prices of fuel, housing and food pushed up the headline inflation over the month. Prices for petrol and diesel increased which were reflected in the rise in private transportation prices. The increase in demand for Kava Tonga and the rise in the electricity prices contributed to the increase in domestic prices. The price of Kava Tonga remained the highest contributor to domestic inflation, rising by 6.8% over the month followed by the electricity prices which increased by 2.6%.

Over the year to December, the headline inflation increased by 6.7%, due mainly to higher prices of imported winfield blue cigarettes, mutton flaps, chicken, sugar, petrol and diesel. This reflects the new customs duties and excise tax introduced in July 2016. The short supply of kava Tonga and the seasonality in local produce over the year drove the inflation on domestic goods. The NRBT anticipates the annual headline inflation rate to be around 2% in the next financial year. However,



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movements in commodity and oil prices may pose a risk to this forecast.

	Monthly			Annual	
	Dec-16	Nov-16	% Growth	Dec-15	% Growth
Nominal Effective Exchange Rate Index	91.5	91.4	0.2	93.5	-2.1
Real Effective Exchange Rate Index	101.2	100.9	0.3	98.5	2.8

In December, the United States Dollar (USD), Chinese Yuan (CNY) and Euro Dollar (EUR) strengthened against the Tongan Pa'anga (TOP) while the Australian Dollar (AUD), Japanese Yen (JPY), New Zealand Dollar (NZD), British Pound (GBP) and Fijian Dollar (FJD) weakened against the TOP. As a result, both the Nominal Effective Exchange Rate (NEER) index and the Real Effective Exchange Rate (REER) index slightly increased over the month. In annual terms, the NEER index continued to depreciate while the REER index rose, which may impact Tonga's international competitiveness.

	Monthly			Annual	
	Dec-16	Nov-16	% Growth	Dec-15	% Growth
OET Receipts (TOP \$ million)	89.4	51.8	72.7	724.5	25.9
Export receipt	3.8	3.0	25.1	20.9	41.6
Travel receipts	11.8	7.6	56.5	94.6	18.9
Private transfers	28.6	20.3	41.1	246.2	18.4
Others	45.1	20.9	116.3	362.7	32.9
OET Payments (TOP \$ million)	47.5	51.5	-7.8	607.0	12.6
Import payments	29.1	27.9	4.1	343.1	9.2
Services payments	11.4	11.1	2.0	136.1	23.7
Primary Income payments	0.7	1.3	-45.3	24.0	47.5
Others	6.3	11.1	-43.4	103.8	5.2

Overseas Exchange Transaction (OET) payments further declined in December 2016 due to lower payments for primary income and other payments particularly in the form of direct investments and private capital payments. This includes payments of dividend by private companies and the return of unspent grant funds by the Government. In year ended terms, however, total OET payments rose, which was driven by higher service payments, mainly for personal travel and freight.

OET receipts increased significantly in December 2016, mainly driven by receipts of official grants and private transfers which included the growth in remittances to its monthly record of \$29.8 million. In year ended terms, the rise in OET receipts was attributed to higher remittances and official grant receipts. The dominant currencies for remittance receipts were USD, AUD and NZD supported by the strengthening of the currencies of these countries against the Tongan pa'anga. This also coincided with the

rise in outbound travel from NZ, Australia and US over the year.

	Monthly			Annual	
	Dec-16	Nov-16	% Growth	Dec-15	% Growth
Foreign Reserves (\$ in million)	378.78	360.94	4.9	327.82	15.5
Import Coverage (months)	9.8	9.1		8.9	

The overall balance for December 2016 was a surplus of \$17.8 million. This contributed to the rise in the official foreign reserves to \$378.8 million by the end of December, equivalent to 9.8 months of imports cover, which is well above the NRBT's minimum range of 3-4 months.

Money	Monthly			Annual	
	Dec-16	Nov-16	% Growth	Dec-15	% Growth
Money Supply (\$ in million)	512.2	493.6	3.8	450.2	13.8
Net Foreign Asset	390.5	366.8	6.5	327.2	19.4
Net Domestic Asset	121.8	126.9	-4.0	123.3	-1.3

The growth in the foreign reserves has largely contributed to the rise in broad money over the month and year ended December 2016. The liquidity (reserve money)¹ in the banking system also increased over December 2016, due mainly to higher currency in circulation as banks' had more cash withdrawals from the NRBT vault to facilitate customers' spending during the festive season.

Lending	Monthly			Annual	
	Dec-16	Nov-16	% Growth	Dec-15	% Growth
Total Lending (\$ in million)	381.6	377.5	1.1	326.0	17.1
Business lending	167.8	166.8	0.6	153.6	9.3
Household lending	212.5	209.4	1.4	171.0	24.2

Total lending by banks continued to increase in December 2016. Lending to households broke another record of \$212.5 million. This was largely contributed by growth in housing loans. This reflects higher borrower capacity and demand for housing by individuals. The growth in business loans was mostly to public enterprises, transport and wholesale & retail businesses. In addition, low interest rates from the Government Development Loans partially supported the higher lending in the manufacturing and agricultural sectors. In year ended terms, credit growth was \$55.6 million (17.1%), which exceeded the \$37.4 million (13.0%) annual credit growth in December 2015. This growth is expected to continue in the near term.

Interest rates declined over December 2016. Lower household and business lending rates caused the decline in the weighted average lending rate. The weighted average deposit rate also declined due to a decrease in the interest rates for all deposit categories. Overall, the weighted average interest rate spread

¹ Sum of currency in circulation, exchange settlement account balances, and required reserve deposits.



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widened to 5.740% in December 2016 as the decline in the weighted average deposit rate outweighed the decrease in the weighted average lending rate.

Interest Rates	Monthly			Annual	
	Dec-16	Nov-16	Growth (bps)	Dec-15	Growth (bps)
Weighted Average Banks Deposit Rate (%)	2.129	2.232	-10.3	2.151	-2.2
Weighted Average Banks Lending Rate (%)	7.869	7.886	-1.7	8.067	-19.8
Weighted Average Interest Rate Spread (%)	5.740	5.655	8.6	5.916	-17.6

Annually, both the weighted average lending rate and weighted average deposit rate fell. The weighted average lending rate however declined more as a result of lower lending rates for households particularly housing, reflecting the housing loan campaign by banks which supported the strong growth in housing loans. Additionally, lower lending rates for businesses contributed to the annual decline, driven mainly by a decrease in the lending rates for manufacturing, agriculture, and construction loans. The weighted average interest rate spread therefore narrowed by 15.5 basis points. Total loans to deposit ratio fell to 74.5% from 76.6% in November 2016. This is still below the 80% minimum loan to deposit ratio target which indicates excess liquidity in the banking system remains. Despite the strong growth in the banks' loan books, this was outweighed by the continuous rise in deposits, which is line with the higher foreign reserves. This signals there is still room for further lending by the banks.

Net credit to government decreased further over the month and over the year by \$13.8 million and \$36.9 million respectively driven by a rise in government deposits. This reflects higher government revenue collection outweighing the government's outflows during the month. Revenue collected from custom duties and excise tax reached another record high in December, as well as the receipt of government grant funds and dividends from public enterprises. This is also in line with the increase in the number of containers and vehicle registrations during the month.

The NRBT's outlook for strong domestic economic activity remains in the near term. The level of foreign reserves is also expected to remain comfortable supported by expected higher receipts of remittances and foreign aid, despite the projected rise in imports. Upward inflationary pressure remains in the near term due to amendments made to custom duty and excise tax effective on 1st July 2016. The banking system remains sound. The NRBT will continue to closely monitor and review its monetary policy setting to maintain internal and external monetary stability, and to promote a sound and efficient financial system in order to support macroeconomic stability and economic growth.