



MONTHLY ECONOMIC REVIEW

Vol. 3

No. 2

Month Ended: February 2016

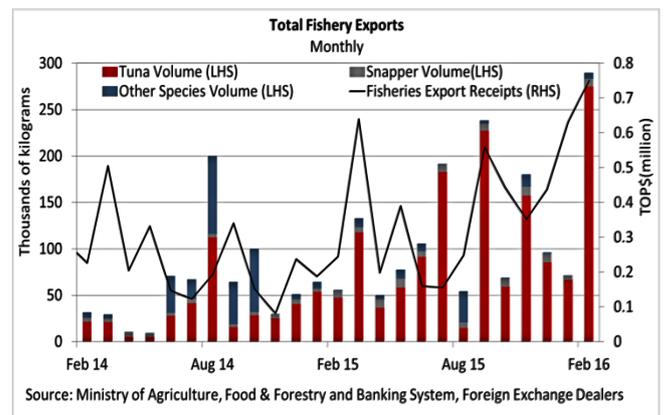
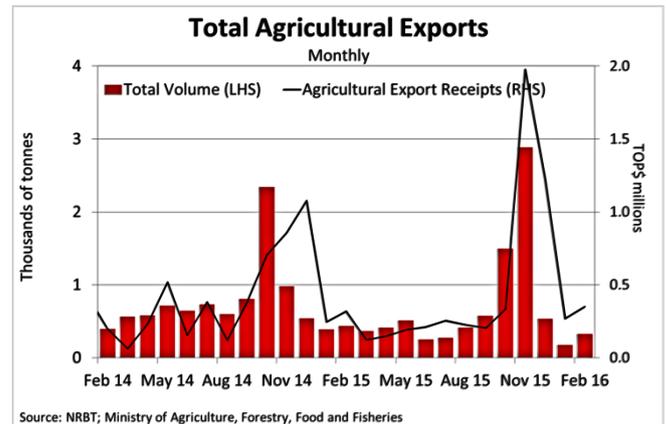
The IMF in its April 2016 World Economic Outlook (WEO) has downgraded its global growth projection to 3.2% in 2016 and 3.5% in 2017. This is owing to an increasing financial turbulence, falling commodity and asset prices and noticeable slowdown in trade. Uncertainties in advanced economies and emerging markets remain, particularly for oil exporting countries. The average price of oil based on futures markets is projected at US\$34.75/barrel in 2016 and US\$40.99/barrel in 2017 relative to US\$50.79/barrel in 2015. Employment in the US, Australia and New Zealand (NZ) grew strongly. Wage growth in the final months of 2015 grew strongly in Australia. NZ dairy prices are around their lowest level in a decade and inflation remains low in the US, Australia and NZ.

The domestic economy in February bounced back after a downturn in the previous month. The rebound of the primary sector is in line with an increase in domestic food prices by 2.1% which is lower than a 2.6% rise in January. Agricultural exports volume increased by 89.3% due to rises in exports of root vegetable products, fruit products and kava products. Exports of cassava, sweet potatoes, taro, yam, breadfruit, brown coconut, papaya and kava products were the main contributors to this increase. Banking data also showed export proceeds for agricultural products rose by 29.7%. Fisheries export receipts continued to rise over the month by 18.9% and total marine exports markedly increased by 305.9% indicating a lively sector. The exports of tuna and snapper continued to remain the highest contributor. This is in line with a significant rise in fisheries exports in February, with tuna exports the highest with 275,097 kilograms. The exports of snapper also rose by 55.4%.

The on-going construction works continue to support the economic activities in the secondary sector. Electricity consumption rose by 6.0% over the month of February 2016 coinciding with a 44.2% rise in electricity consumers.

The performance in the services sector was mixed over the month. Total number of container registrations fell by 7.7% due to delays in shipping

lines schedules caused by Tropical Cyclone Winston during the month. The international arrivals however rose by 40.5% driven by the arrivals of scheduled cruise ships and the unexpected arrival of one cruise ship redirected from Fiji due to Tropical Cyclone Winston. However, travel receipts declined by \$1.4 million over the month reflecting the decrease in air arrivals. The transport sector benefitted from the low global oil price as local fuel prices fell during the month. Vehicle import payments declined by 38.4% which is consistent with a 23.9% fall in vehicle registrations. The financial sector remained strong during the month and continued to record higher credit and deposit growth.





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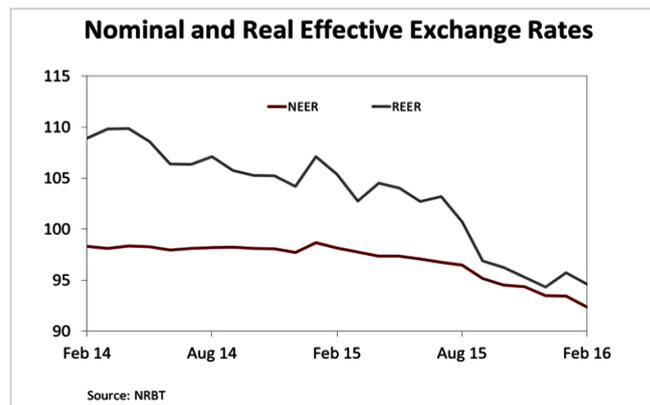
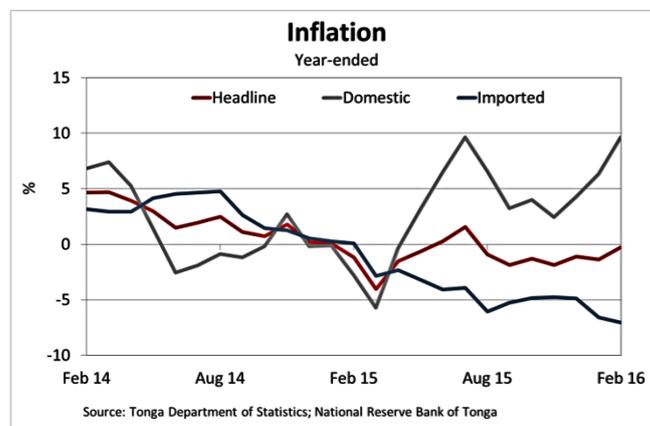
The total number of job advertisements¹ over the month maintained at the same number advertised as in January. The Public Administration continued to record the highest number of vacancies advertised. Over the year, job advertisements fell by 15.9% due to lower number of advertisements for the Industry and Services sectors indicating lower unemployment.

The hike in the price of Kava-Tonga drove the increase in headline inflation over the month by 0.4%. The low production of Kava-Tonga reflects the lag effects of the drought from previous years. Domestic food prices rose by 2.1% due to increases in the prices of watermelon, pineapple, dry coconut, peanuts, carrots, tomatoes and pele leaves. The domestic prices for Housing, Household operations, Clothing & Footwear remained unchanged in February. However, imported prices continue to fall by 1.0% over the month as a result of a 2.8% decline in prices for diesel and petrol, offsetting a 1.9% rise in the price of house maintenance goods.

In the year to February, headline inflation fell by 0.3% which was driven by a 7.1% decline in imported prices. Imported food prices decreased by 13.8% due to a decline in prices for almost all items such as potatoes, onions, apples, mutton flaps, chicken pieces and flour. Household prices dropped by 4.0% particularly on domestic fuel & power and also household supplies & services. Transportation prices also fell by 1.7% due to lower prices of crude oil.

In contrast, domestic prices increased by a record 9.7%. This was caused mainly by a significant increase in Tobacco, Alcohol & Kava prices by 43.1% specifically on Kava-Tonga. Prices for Miscellaneous goods & services rose by 24.9% due to higher stamp (air mail) prices. The increase in domestic prices also reflects lower food production due to the lag effects of unfavorable weather conditions over the year. This includes higher prices

for taro, cassava, yams, lu, tomatoes, capsicum, ripe banana, watermelon, pineapple, pawpaw, coconuts, tuna fish, cockles and also stringed fish. In addition, prices of Housing and Household operations also rose by 2.4% and 1.8% respectively. The National Reserve Bank of Tonga (NRBT) continues to expect that headline inflation will remain low in the near term. However, risks to this forecast would be developments in world oil and food prices for both domestic and imported inflation.



The Tongan Pa'anga depreciated against the New Zealand Dollar (NZD), Australian Dollar (AUD), Fijian Dollar (FJD), and the Japanese Yen (JPY) over the month of February 2016, leading to a fall in the Nominal Effective Exchange Rate (NEER) by 1.2% over the month. The lower NEER combined with Tonga's low headline inflation contributes to the

¹ This is based on job advertisements published on local newspapers (Taimi, Talaki and Kele'a) and the Matangi Tonga Website



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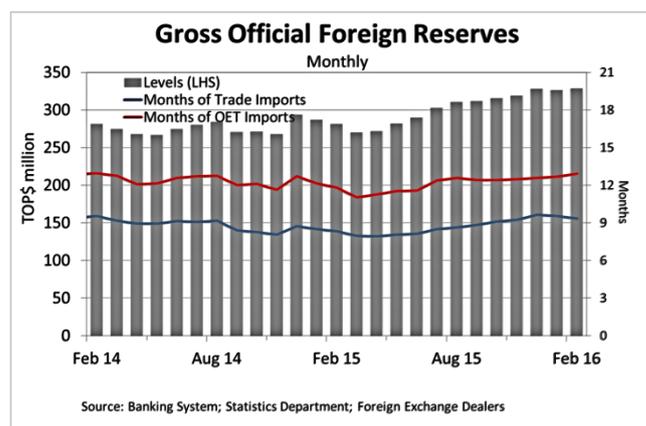
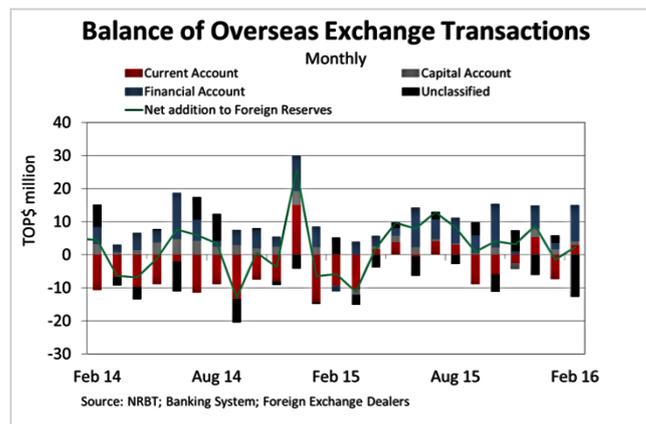
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decline in the Real Effective Exchange Rate (REER) by 1.2%. Over the year, both the NEER and the REER deteriorated at a faster rate of 5.9% and 10.2% respectively, benefitting the exports and tourism industries and encourages remittances as Tonga maintains its price competitiveness against that of its major trading partners.

Total outflows of Overseas Exchange Transactions (OET) for February 2016, further declined by 7.2% to \$39.8 million, attributed mostly to a 5.4% fall in current account payments. Driving this fall were lower import payments recorded for the month of 21.6%, coinciding with a 7.7% fall in container registrations, and this was supported by a \$1.8 million drop in payments for wholesale and retail imports. A sharp drop of \$5.9 million in oil import payments also contributed to the lower current account outflows. Services payments however, rose over the month by 21.2%, due to an increase in payments for telecommunication services.

Total OET inflows made a strong comeback over the month of February, rising by 39.7% to \$54.7 million, in contrast to a decline of 34.2% in the previous month. A rebound in both the financial and current account receipts by the end of the month, supported the growth in OET receipts. All receipts from the current account categories rose over the month, with transfers rising the most by 17.2%, due to receipt of official grants, and higher remittances, followed by primary income with 92.8% and services with 12.4%. The 7.2% rise in remittances shows the impact of the strong growth in employment at Australia, New Zealand and the United States and the weakening of the Tongan Pa'anga against that of its major trading currencies. The remittance receipts in USD still dominate by a share of 43%, followed by AUD at 30% and NZD at 21%. Exports receipts also rose by 58.2% underpinned by higher proceeds from exports of marine products and other exported goods. Financial account receipts climbed to \$14.1 million over the month, which was 208.5% higher than the previous month, owing mostly to

interbank transfers with overseas correspondent banks for foreign exchange deals.



For the month ended February 2016, the balance of overseas exchange transactions, which is the net change to foreign reserves stood at a surplus of \$2.3 million, recovering from a deficit of \$1.6 million last month. The improvement in the net current and net financial accounts resulted in the higher overall balance. Official foreign reserves remains comfortable, reaching yet another record high of \$328.5 million by end of February, equivalent to 9.3 months of import cover, well above the NRBT's minimum range of 3-4 months.²

Broad money rose over the month by 2.0% to \$456.5 million. This resulted from a 3.0% increase in net domestic assets and a 1.6% rise in net foreign assets. The increase in banks' lending resulted in

² IMF projects the level of foreign reserves for 2015/16 as equivalent to 7.6 months of imports cover. Their method of calculation is based

on imports over the next 12 months, whereas NRBT uses import data from the past 12 months.



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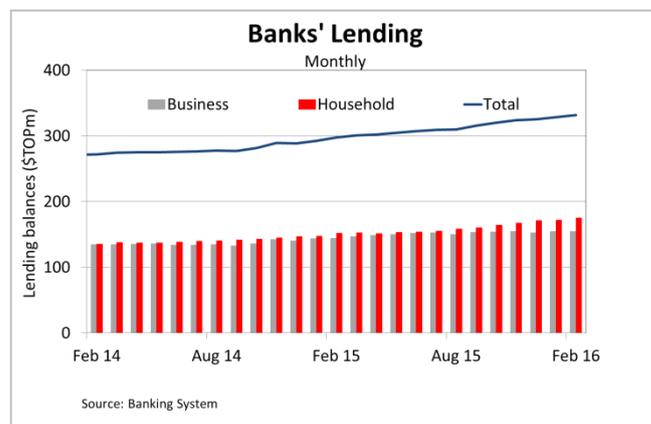
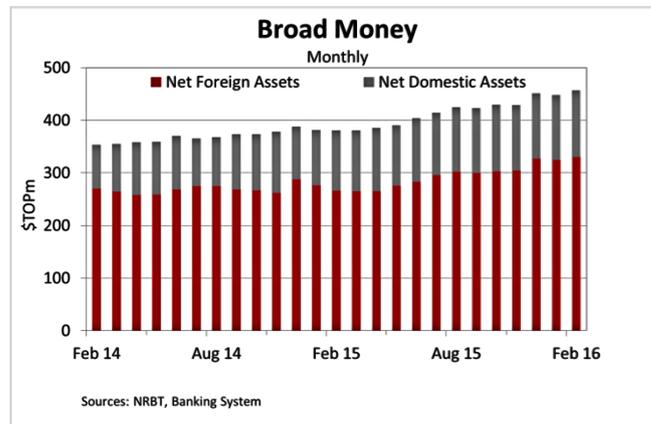
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higher net domestic assets and the increase in net foreign assets was driven by higher foreign reserves. Banking system liquidity also increased over the month by 1.8% to \$177.9 million, largely resulting from an increase in banks' cash deposits to the NRBT vault. This is in line with a 0.4% decline in currency in circulation over the month. Over the year, broad money increased by 20.2%, reflecting rises in both net domestic assets and net foreign assets.

Overall minimal movement was recorded for total bank lending over the month, rising by 0.9% to \$331.9 million. This was driven by a 1.9% growth in household loans, offsetting a 0.2% decline in business loans. The increase in household loans resulted mainly from continued growth in housing loans. This has been supported by ongoing competitions particularly the housing loans campaigns and refinancing of housing loans amongst banks. The on-going construction works support the housing and construction industry. However, the decline in business loans reflected loan repayments made by agricultural and trade business, implying improvements in business cash flows. In year ended terms, total bank lending rose by 11.6%, underpinned by increased lending to both households and businesses.

Weighted average lending rate declined over the month by 1.0 basis points to 8.03%, while weighted average deposit rate rose slightly by 0.3 basis points to 2.19%. As a result, weighted average interest rate spread slightly narrowed over the month from 5.85% to 5.84% in February 2016.

Net credit to government rose over the month by 5.5% due to a 3.7% decrease in government deposits as the proceeds from the government bond issue in January had boosted the government deposit balances last month. Over the year to February 2016, net credit to government rose by 8.3% driven by a 0.5% rise in government deposits, due to receipt of budgetary support and government bonds issued during the year.



Against the background of continued deflation, foreign reserves remaining comfortably above the minimum range of 3-4 months of import cover, positive credit growth and the banking system remaining sound, the current monetary policy stance remain appropriate in the near term, which is consistent with the recent assessment by the 2016 IMF Article IV mission. Nevertheless, the NRBT is considering measures to ensure the excess liquidity in the banking system are being well utilised to support economic growth. At the same time, the NRBT is exploring alternative monetary policy tools and macroprudential tools to strengthen the transmission mechanism and ensure financial stability is maintained. The NRBT will closely monitor the country's economic and fiscal developments and financial conditions to maintain internal and external monetary stability, and promote a sound and efficient financial system to support macroeconomic stability and economic growth.