



MONTHLY ECONOMIC REVIEW

Vol. 3

No. 3

Month Ended: March 2016

Recovery in overseas economies has been uneven, and uncertainties in the global outlook remain. Real Gross Domestic Product in the US increased by 0.5% in the first quarter (Q1) of 2016 compared with a 1.4% growth in the fourth quarter of 2015. Business investment declined and consumer spending slowed in Q1 2016 relative to Q4 of 2015. The Consensus anticipates investment and industrial production to continue falling in the US and the International Monetary Fund also cut the US growth forecast for 2016 from 2.8% in its October 2015 World Economic Outlook (WEO) to 2.4% in its April 2016 WEO. The Consensus forecasts the Australian economy may be struggling to sustain its positive growth momentum from the last quarter 2015 into 2016 due to a fall in both domestic and external demand. New Zealand has shown resilience in the face of depressed global dairy prices, and Consensus forecasts that it will continue to grow moderately at 2-3%. Meanwhile, China continues its reform programs to open up its economy in order to avoid a hard landing in light of its recent currency volatility and heavy capital outflows. Brent oil price has stabilized between US\$35-45 buoyed by signs of firming demand in China. The US dollar has weakened in recent months up to March due to soft economic activities and low US inflation.

Activities in the domestic economy continued to grow supported by construction, trade, credit growth and the declining world food and oil prices. The domestic food prices had increased over the month, indicating a decline in the supply of domestically produced food. However, agricultural exports volume rose over the month by 15.3 tonnes, owing to higher export of fruit products particularly brown coconuts and breadfruits (Figure 1). The High Temperature Forced Air machine resumed operation at the Fua'amotu International Airport which assisted the higher exports of breadfruits. Agricultural export proceeds also slightly increased by \$0.03 million (9.1%) over the month. Total marine exports, however, fell by 166 metric tons (55.5%), driven by a decrease in the

export of tuna. Proceeds for the fisheries¹ exports also declined by \$0.25 million (31.8%) over the month of March (Figure 2).

Electricity consumption continued to increase by 8.8% (0.4 million KWh) in March. This follows from a 6% growth in February and is in line with the growing construction sector. Electricity production also increased by 3.5% (0.19 million KWh). The number of electricity consumers also increased by 99 over the month of March.

The construction industry continued to grow strongly. The growth in private housing construction continued, supported by a \$0.02 million (2.1%) rise in housing loans and \$1.3 million increase in importation of construction materials over the month.

Figure 1:

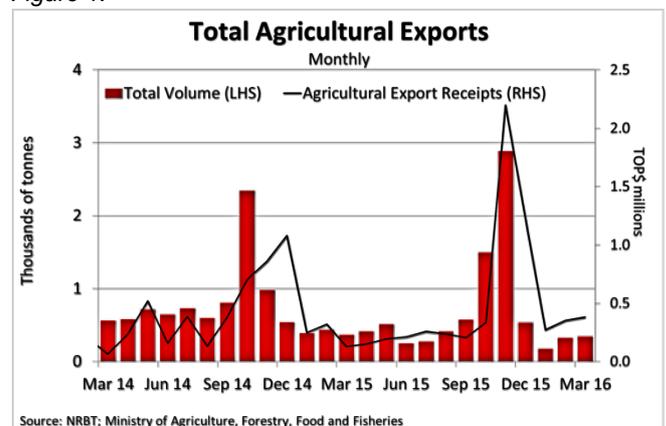
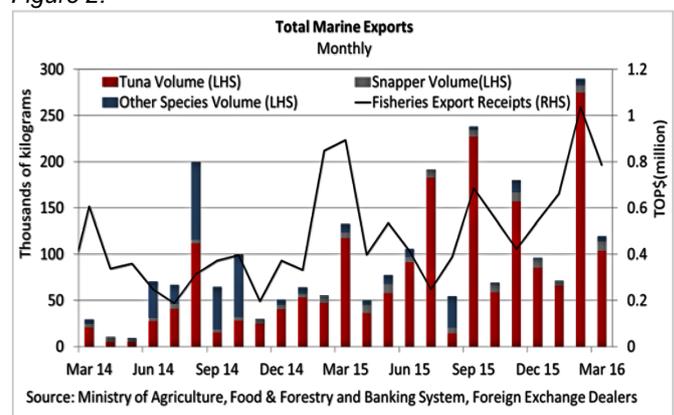


Figure 2:



¹ Includes fisheries & other marine products



MONTHLY ECONOMIC REVIEW

Vol. 3

No. 3

Month Ended: March 2016

The number of tourist arrivals (both air & sea) in Tonga fell by 4,070 passengers over the month due mainly to lower arrivals by cruise ships, which impacted the activities in the transportation and handicrafts sector. However, the delays in shipping lines schedules in February resulted in a significant rise in the total number of container registrations in March by 375 registrations. Import payments (excluding oil) also rose over the month by \$2.2 million. The transportation sector benefitted from the low global oil price as local fuel prices fell during the month. Vehicle import payments rose by \$0.3 million and 193 new vehicle registration recorded over the month. Activities in the financial sector remained strong supported by continued credit growth.

The total number of job advertisements over the month rose significantly to about 60 vacancies. Public Administration continued to record the highest number of vacancies advertised, as government ministries intend to fill in their vacancies before the closing of the fiscal year. Over the year, job advertisements also rose by 30.6% due to an increase in the number of vacancies advertised on the Services sector. This indicates a rising demand for labour in Tonga and may assist in reducing the unemployment rate.

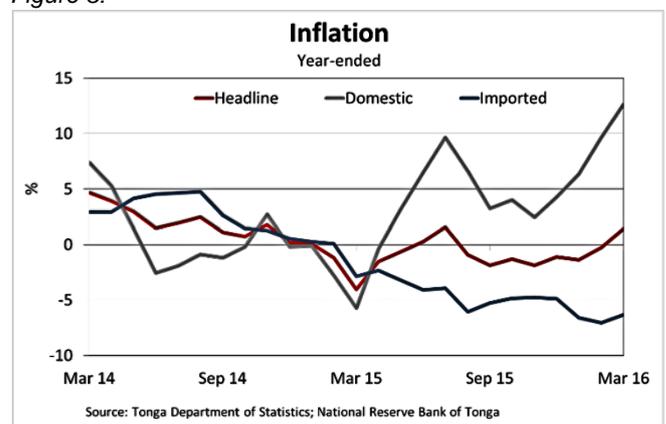
Lower imported prices (-1.7%) caused a decline in the headline inflation over the month by 0.1%. Prices for petrol & diesel and tobacco declined by 4.0% and 3.9% respectively. Imported food prices also fell by 2.2% for items such as potatoes, apples and mutton flaps. The price of house maintenance goods dropped by 2.1%. Domestic prices however, rose by 1.9% over the month as a result of a 6.7% increase in food prices. This includes higher prices for talo futuna, cassava, tomatoes, cabbage, taro tarua leaves, pineapple and pele leaves. Prices of Kava-Tonga also rose by 5.1%.

Annual headline inflation rose by 1.4%, following seven consecutive months of deflation (*Figure 3*). This was mainly due to a 12.6% rise in domestic prices driven by a significant increase of 90.7% in the price of Kava-Tonga. The Agricultural Census

2015 revealed that agricultural land used for Kava-Tonga plantation significantly dropped from 5,273 acres in 2001 to only 1,257 acres in 2015 supporting the short supply of kava Tonga and the continued high kava Tonga prices. Domestic food prices rose by 19.4% due to an increase in the prices of talo (futuna & tonga), cassava, yams (early & late), taro tarua leaves, tomatoes, capsicum, ripe bananas, watermelon, coconuts (dry & green) and pineapple. The unfavourable weather conditions during the year had affected the agricultural output. Prices of house maintenance goods and services also increased by 6.3% and 2.2% respectively.

In contrast, imported prices decreased by 6.3% over the year, due to a 11.7% decrease in imported food prices. All imported food prices fell over the year, with mutton flaps and chicken pieces decreasing the most. Price control by the Tonga Competent Authority on chicken contributed to the fall. A decline in prices for petrol & diesel (5.5%) and electricity prices (4.7%) coincides with the drop in global oil prices. This offset the increases in prices for clothing and footwear (8.6%) and alcohol (7.6%). 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.

Figure 3:





MONTHLY ECONOMIC REVIEW

Vol. 3

No. 3

Month Ended: March 2016

In March 2016, the Nominal Effective Exchange Rate (NEER) fell by 0.6% indicating a depreciation of the Tongan Pa'anga against that of its major trading currencies (*Figure 4*). This was underpinned by the depreciation of the Tongan Pa'anga against the New Zealand Dollar (NZD), Australian Dollar (AUD), Euro (EURO) and the British Pound (GBP). The Real Effective Exchange Rate (REER) also fell by 1.1% over the same month, supporting Tonga's price competitiveness against that of its major trading partners. Over the year, both the NEER and the REER declined at a faster pace of 6.1% and 8.9% respectively.

Total Overseas Exchange Transactions (OET) payments rose in March by \$15.9 million (39.9%) from the previous month to \$55.6 million. Driving this rise was an increase of \$8.1 million (275.0%) mostly in the form of inter-bank transfers for foreign exchange deals. Current account payments also increased by \$7.8 million (21.3%), mostly for imports and primary income. Import payments rose by \$4.7 million (22.1%) in March, due to higher payments made for oil, construction materials, and wholesale and retail goods. This coincides with the increase in container and vehicle registrations. The higher payments for primary incomes were mostly interest payments on external loans.

In contrast, total OET receipts fell over the month of March 2016, by \$9.9 million (18.0%) to \$44.8 million. This fall was largely attributed to a \$5.7 million (40.3%) decline mostly in the form of interbank transfers. Current account receipts also declined by \$3.7 million (9.3%), specifically official transfer, as there were lower receipts of government grants this month compared to the previous month. On the other hand, receipts received by businesses and non-profit organizations increased over the month by \$0.9 million (5.1%) and \$1.7 million (124.9%) respectively. Remittances have also increased over March by \$0.9 million (4.6%) to \$19.4 million, of which 92% are from personal transfers. Remittance received over the month in AUD and NZD rose whereas receipts in USD fell, reflecting the depreciation of the TOP against the AUD and NZD,

Figure 4:

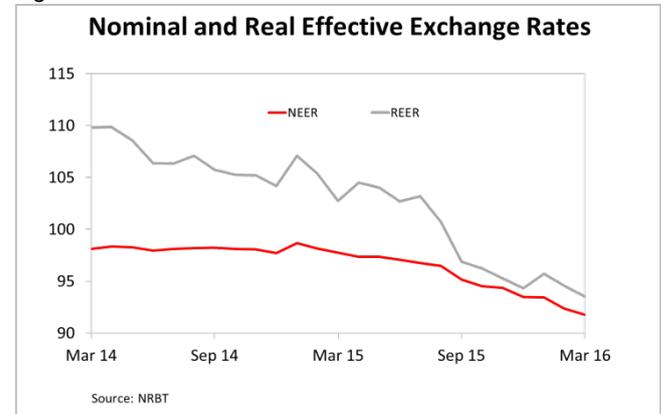
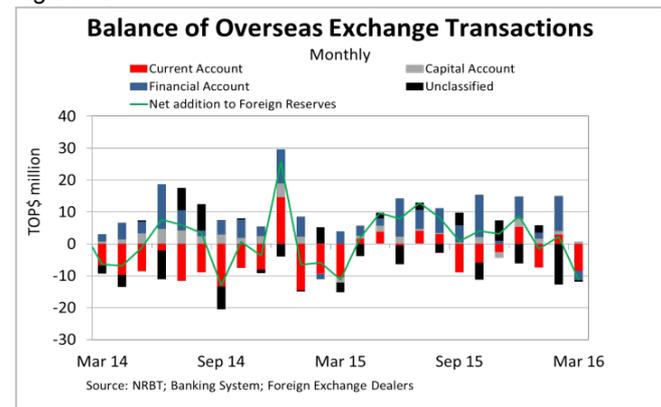


Figure 5:



and its appreciation against the USD. Total export receipts decreased by \$0.3 million (17.3%) over March, driven by a fall in proceeds from exports of fish and marine products, offsetting the rise in proceeds from agricultural exports. This is consistent with the decrease in volume of exported marine products and the higher volume of exported breadfruits. Services receipts also declined by \$0.7 million (6.3%), to \$10.4 million. Travel receipts decreased by \$0.3 million contributing to this fall, in line with the fall in international arrivals.

The balance of OET for March 2016, which is the net change to the foreign reserves, was a deficit of \$11.2 million, in contrast to a surplus of \$2.3 million in the previous month (*Figure 5*). The net deficits in the current and financial accounts contributed to the overall deficit. However, the official foreign reserves still remains at a comfortable level of \$317.3 million (*Figure 6*) at the end of March,



MONTHLY ECONOMIC REVIEW

Vol. 3

No. 3

Month Ended: March 2016

equivalent to 9.0 months of import cover, well above the NRBT's minimum range of 3-4.months.²

Broad money fell over the month by \$4.9 million (1.1%) to \$451.6 million, due to a decline in net foreign assets by \$14.0 million (4.2%) (Figure 7). The lower net foreign assets coincides with the fall in the official foreign reserves. This offset an increase in net domestic assets of \$9.1 million (7.2%). The liquidity in the banking system has also decreased by \$12.9 million to \$165.0 million driven by a decrease in banks' deposits to the NRBT vault. This coincides with a slight increase in the currency in circulation of \$0.8 million. Over the year, broad money rose by \$72.0 million (19%) reflecting rises in both net domestic assets and net foreign assets.

The increased competition in the banking sector led to rapid growth in banks' lending. Total bank lending increased over the month by \$6.0 million (1.8%) to \$337.9 million (Figure 8). Banks' lending to both businesses and individuals rose with business loans increasing the most by \$4.0 million (2.6%). The higher business loans were mainly due to rises in lending to the tourism, manufacturing and construction sectors. This is supported by a decline in banks' interest rates on tourism and manufacturing loans over the month. In addition, household loans continued to grow by \$2.7 million (1.6%) to a new record driven by the competitive housing loan interest rates amongst banks. The on-going construction works support the housing and construction industry. Over the year, total bank lending also rose by 12.2% (\$36.7 million) underpinned mainly by increases in both household (16.7%) and business (7.6%) lending.

Weighted average lending rate fell over the month by 8.4 basis points to 7.94%, while weighted average deposit rate rose by 4.2 basis points to 2.23%. Increased competition amongst banks has driven the lower weighted average lending rate

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.

Figure 6:

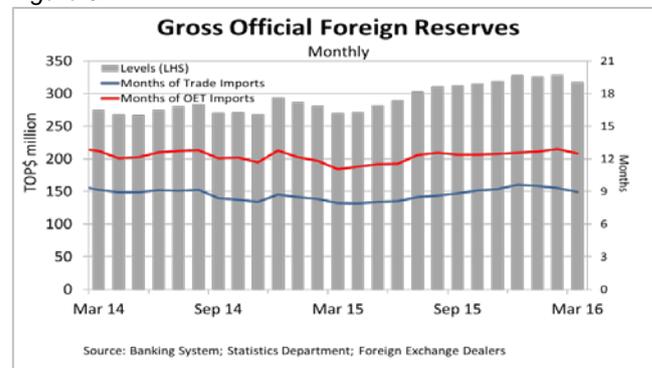


Figure 7:

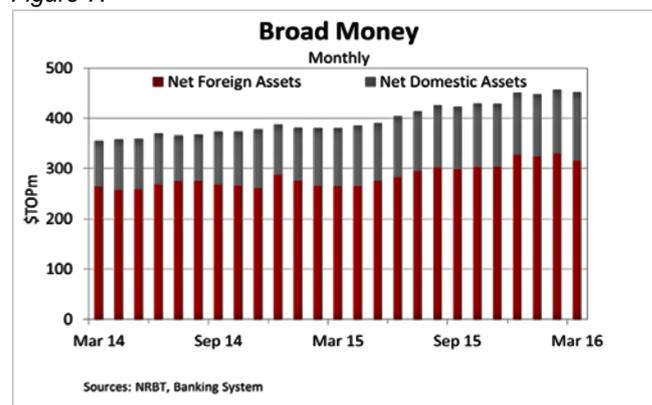
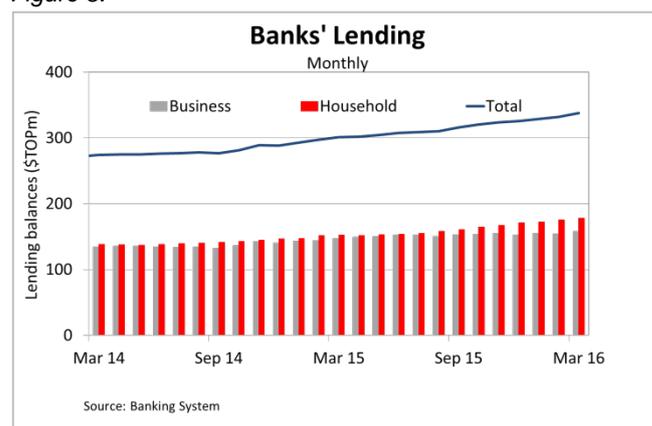


Figure 8:



underpinned mainly by declines in businesses and other personal lending rates whilst an increased in weighted average term deposit rate by 6 basis points to 3.95% caused the increase in weighted average deposit rate. As a result, the weighted average interest rate spread narrowed over the month from 5.84% to 5.71% in March 2016. In year ended terms, both weighted average deposit and



NATIONAL RESERVE BANK OF TONGA

MONTHLY ECONOMIC REVIEW

Vol. 3

No. 3

Month Ended: March 2016

lending rates fell with lending rate decreasing the fastest by 38.2 basis points, resulting in the weighted interest rate spread narrowing by 28.8 basis points.

Net credit to government rose over the month by \$4.3 million (8.8%) due to a \$4.2 million (5.8%) decrease in government deposits, reflecting high external debt service payments made during the month. Over the year to March 2016, net credit to government rose by 13.3% driven by a 2.9% decline in government deposits as government clears its commitments and payments obligations.

The NRBT expects the domestic economic activity to remain strong in the near term. The projected growth in the domestic economy brings with it risks of lower foreign reserves and higher inflation. However, the level of foreign reserves is expected to remain comfortably above the minimum range of 3-4 months of import cover. Imports are projected to rise given the increased construction projects, however, the expected receipts of remittances and

foreign aid funds will help to ease the downward pressure on foreign reserves. Inflationary pressure remains low due mainly to the declining global food and oil prices. Given the above, together with the banking system remaining sound, the current monetary policy stance remains 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 macro prudential 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.