



## MONTHLY ECONOMIC REVIEW

Vol. 3

No. 5

Month Ended: May 2016

Global growth outlook for 2016/17 was downgraded by 0.1% to 3.4% due to increased uncertainty following the outcome of the U.K referendum to exit from the European Union. The outlook for the United States economy has worsened due to further falls in business investment and similarly latest data confirmed persistent weakness in China's growth despite hopes for recovery at the end of the first quarter. Meanwhile, the Australian economy expanded by 1.1% in the first quarter, whilst New Zealand continues to argue for monetary easing.

Indicators of domestic activity over the month were mixed but overall, broadly positive. This was supported by strong performance in the secondary sector, namely construction, trade and credit growth. Lower export of root crops, fruits and vegetable products supported the decline of 326.6 tonnes (43.0%) in total agricultural export volumes over the month (Figure 1). Total marine exports on the other hand, continued to rise by 34.3 metric tonnes (24.1%), driven by an increase in exports of tuna, snapper and shark meat (Figure 2).

On-going construction activities continued to boost performance in the secondary sector. Electricity consumption rose by 0.38 million kWh (8.5%) over the month, coinciding with a 0.2% rise in electricity consumers. Increases in private housing loans and business loans for construction and manufacturing also support the expansion of this sector. Activities in the financial sector remained strong during the month supported by continued credit growth.

Activities in the services sector varied over the month. An additional 3 cargo ships arrived in May driving the rise in container registrations by 68 registrations (8.5%). However, the tourism sector was negatively impacted due to international arrivals declining by 1,446 passengers (14.2%), driven by a decline in arrivals by cruise ships. The transport sector slowed as a result of an increase in the local fuel price, despite the rise in the number of vehicle registrations reaching a new record high of 360 registrations.

The total number of job advertisements slightly increased over the month by 2 vacancies in Public

Figure 1:

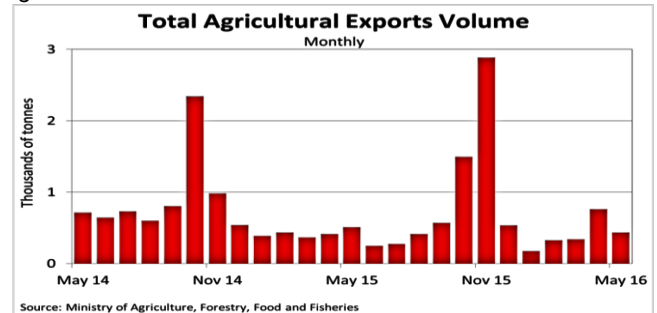


Figure 2:

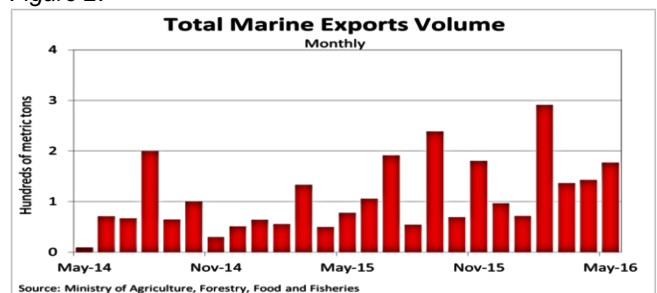
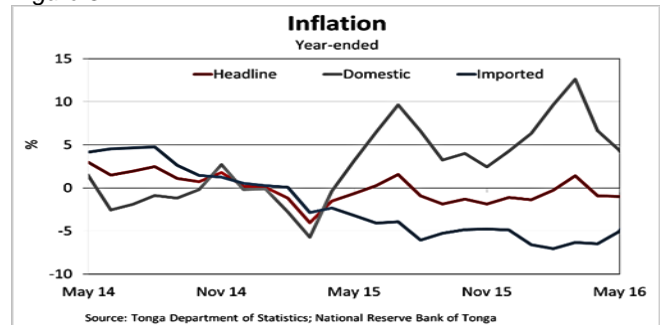


Figure 3:



Administration. However, it is anticipated that the new government budget for the new financial year, will support growth in the labour market given that government ministries can now fund new vacancies, supporting lower unemployment rate.

Lower prices for domestic food caused a slight decrease in headline inflation over the month by 0.2%. Declining prices for fruits and vegetables contributed to the 1.8% fall in domestic prices, offsetting the 1.1% rise in imported prices. Despite rising transportation and household operations costs due to higher global oil prices, it was still insufficient to offset the lower domestic food prices. Imported food prices continued to increase by 1.4% reflecting supply shortages of sugar and flour.



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Headline inflation recorded deflation of 1.0% over the year ended May, due to imported prices declining by 5.0% offsetting a 4.4% rise in domestic prices (Figure 3). Declining import prices was driven by lower prices of imported food items, fuel and electricity. The rise in domestic prices was largely attributed to higher Kava-Tonga and domestic food prices.

The U.S Dollar (USD) strengthened in May over speculation of a rate hike by the Federal Reserve, while the Australian dollar (AUD) and the New Zealand dollar (NZD) weakened as a result of anticipated monetary policy easing. As a result, the Nominal Effective Exchange Rate (NEER) slightly strengthened over the month by 0.04% (Figure 4), whereas the Real Effective Exchange Rate (REER) fell by 0.26%, thus Tonga's exports still remains competitive. Over the year, both the NEER and the REER declined by 6.2% and 8.1% respectively.

Total Overseas Exchange Transaction (OET) payments rose sharply by \$8.5 million (18.3%) in May 2016 to \$55.1 million. This was largely attributed to import payments rising over the month by \$8.9 million (35.3%) to \$34.1 million. Payments for imports of oil increased the most followed by payments for wholesale and retail goods, motor vehicles and construction materials. This reflects a more active domestic economy during the special celebrations in May, along with the preparation for the upcoming events in June.

Total OET receipts in May remained high, rising again by another \$1.2 million (2.1%) from the previous month to \$59.8 million. Inflow of government grants and budgetary support continued to support high official transfer receipts keeping it above \$10 million over the month. Receipts of private transfers rose over the month by \$4.6 million (25.4%), reflecting higher remittances received for the special celebrations in May. Export receipts slightly rose by \$0.2 million (27.1%) over the month to \$1 million due to increasing proceeds from agricultural and marine exports. Conversely, services receipts fell by \$0.7 million (6.6%) to \$10.4 million, underpinned by lower receipts from travel services.

Figure 4:

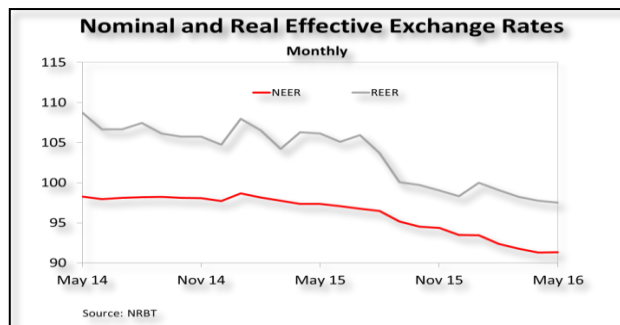


Figure 5:

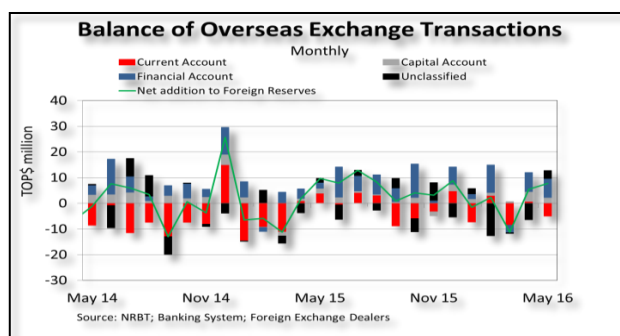
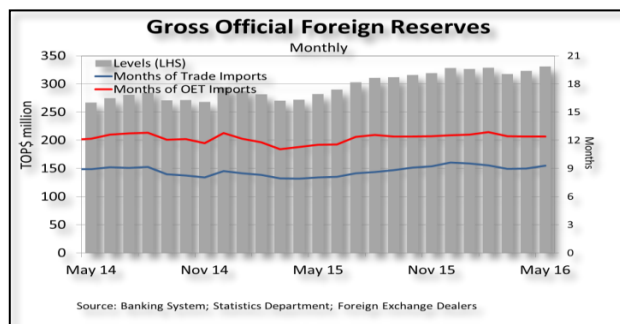


Figure 6:



The balance of OET for May, which is the net change to foreign reserves, was therefore a surplus of \$7.8 million, which was \$2.3 million higher than the surplus last month (Figure 5). Despite the higher deficit balance of the trade account, improved data collection enabled the capturing of the exchange of foreign currencies supporting higher remittance activities and contributing to the improved overall surplus. Official foreign reserves remained comfortable at \$330.7 million (Figure 6) at the end of May, equivalent to 9.3 months of import cover,



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well above the NRBT's minimum range of 3-4 months of import cover.<sup>1</sup>

Broad money rose over the month by \$12.1 million (2.7%) to \$460.5 million. This stemmed from a \$12.2 million (3.8%) increase in net foreign assets (Figure 7). An increase in foreign reserves drove the higher net foreign assets. The liquidity in the banking system (reserve money) also increased over the month by \$7.7 million (3.2%) to \$249.4 million, due mainly to a rise in currency in circulation. In year ended terms, broad money increased by \$70.7 million (18.1%), as a result of rises in both net foreign assets and net domestic assets.

Total bank lending broke another record high of \$348.7 million in May (Figure 8). Household loans were the main contributor, due mainly to rises in both housing and vehicle loans which indicates strong consumer demand. Meanwhile, increased activities in the agricultural, manufacturing and tourism sectors fuelled the growth in business loans. This was supported by low interest rates from the Government Development Loans scheme. Annually, total bank lending rose by \$44.1 million (14.5%), with household loans increasing the fastest.

Weighted average lending rate fell over the month by 9.1 basis points to 7.88%, due mainly to a decline in the weighted average business lending rate. The weighted average deposit rate also fell by 3.4 basis points to 2.22%, reflecting falls in the weighted average demand and term deposit rates. As a result, the weighted average interest rate spread narrowed by 5.7 basis points to 5.66% in May 2016. In year ended terms, both weighted average deposit and lending rates fell, resulting in the weighted average interest rate spread narrowing by 29.3 basis points from 5.95%.

Net credit to government increased over the month by \$1.2 million due mainly to an increase in banks' government bond holdings, but fell over the year by

Figure 7:

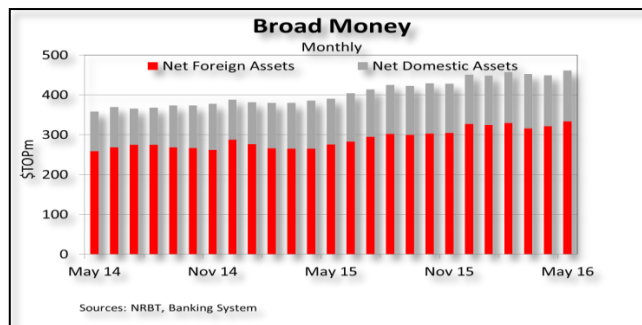
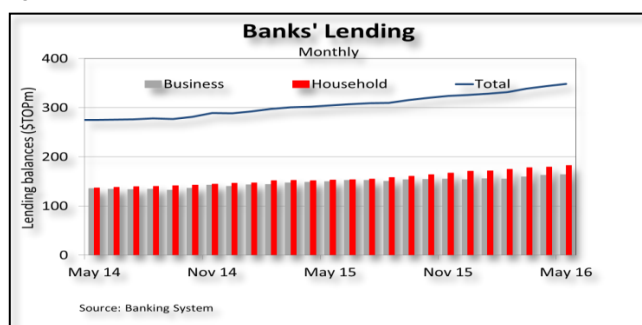


Figure 8:



\$0.1 million due to rising government deposits.

The NRBT expects the domestic economic activity to remain strong in the near term. The level of foreign reserves is expected to remain comfortable supported by the expected receipt of remittances and foreign aid, despite the projected rise in imports. Inflationary pressure remains low due mainly to the low global food and oil prices. The banking system remains sound. The current monetary policy stance therefore remains appropriate in the near term, which is consistent with the recent assessment by the 2016 IMF Article IV mission. 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.

<sup>1</sup> IMF projects the level of foreign reserves for 2015/16 as equivalent to 7.6 months of imports cover.