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Mission Statement at the Conclusion of the 2014 Article IV Consultation with the Kingdom of Tonga

An International Monetary Fund (IMF) mission, led by Mr. Jookyung Ree, visited Nuku'alofa during April 15-29 to conduct the 2014 Article IV consultation discussions. The mission met with Minister for Finance & National Planning 'Aisake Valu Ake, Governor of the Reserve Bank of Tonga Sione Ngongo Kioa, other senior government officials and private sector representatives.

At the conclusion of the mission, Mr. Ree issued the following statement:

“Tonga’s economy appears to be rebounding, supported by the recovery in agriculture and other sectors. The tourism outlook is improving. The reconstruction from a recent cyclone and the preparation for the 2019 South Pacific Games are expected to lead to both additional financing needs and a temporary boost to growth. Risks to the inflation outlook and the external position are low.

“Real GDP growth is projected to recover to 1½ percent in Fiscal Year 2013-14, and to accelerate to 3½ percent in 2014-15. The output loss caused by the tropical cyclone Ian is expected to drag growth down slightly in 2014 but reconstruction activity would substantially boost growth in 2015. Thereafter, growth is projected to gradually approach the historical trend, supported by remittances, tourism, as well as credit growth.

“Risks to the near-term outlook are tilted to the downside. The tapering of quantitative easing by the U.S. Federal Reserve may generate global spillovers and affect Tonga through its interconnectedness with Australia and New Zealand. On the domestic side, slippages in critical reforms may pose risks to macroeconomic stability.

“The IMF mission expects that the projected fiscal cost relating to the cyclone will be broadly met by available financing sources. Maintaining fiscal sustainability will require fiscal consolidation over the medium term. Wage restraint—in line with the authorities’ target—and revenue reform, including broadening the consumption tax base, would be needed.

“Coming on top of significant reconstruction needs, the 2019 Games could potentially pose risks to fiscal sustainability. The mission recommends streamlining the Games to guard against such risks.

“The deleveraging cycle of the Tongan banks appears to be ending, and thus National Reserve Bank of Tonga should stand ready to unwind the accommodative monetary policies, while being mindful of potential risks stemming from this process. The mission notes that structural reforms addressing bottlenecks in credit infrastructure need to be pursued with renewed vigor.

“The authorities’ resolve to diversify its economy and promote tourism, agriculture, and fishery sectors, while recognizing potentials in other sectors, is welcome. Continued improvement of the business environment, including through judicious deregulation, and boosting investor confidence will be crucial.

“The authorities’ intention to gradually phase out existing ad-hoc tax incentives is well-placed, and will help enhance the transparency and discipline of tax expenditures. The mission recommends a regular review of investment incentives based on measurable outcomes. A robust revenue reform to broaden the tax base should be put in place to mitigate negative revenue impacts of new tax incentives.

“The mission welcomes the authorities’ intention to continue civil service reform and to finalize a public finance management reform roadmap.”