

# Monthly Economic Review

## November 2014

Developments among Tonga's key trading partners were mixed yet continue to support domestic activity. Unemployment in the US remained unchanged at 5.8% while it climbed in Australia to 6.3%. China's trade surplus widened to a new record high of US\$54.5 billion supported by an increase in exports of 4.7%.

Domestically, economic growth was broadly positive despite a flagging primary sector. The agricultural sector contracted in line with export volumes declining by 37.0% relative to the same time last year. The decline was due to recent drought affecting crops' yields. The distribution sector was boosted by a 21.6% increase in container registrations. Both the formal and informal parts of the sector would have benefited from the increase in business and private container registrations. The rise is also supported by an increase of 4.8% in bank loans to the distribution sector. The transport sector is benefitting from a 34.1% increase in new vehicle registrations compared to November last year which would also contribute to year-ended growth. The continued decline of global oil prices is also helping the sector. Tourism activity slowed in November though, due to a 2.4% decline in international air arrivals and also no cruise ships arriving on our shores. The industry sector is expected to strengthen supported by an increase in private housing loans over the month.

Headline inflation increased over the month due to increases in food prices, particularly for Fruits & vegetables and imported Meats, fish & poultry. The

major contributors to higher prices were higher domestic food prices due to limited supply and the strengthening New Zealand dollar over the month. Annual headline inflation was 1.8% in November, up from 0.7% in October and 0.6% in November 2013. The increase in headline inflation was due to rises in prices for Food, Clothing & footwear and Miscellaneous goods & services. It is also in line with price increases in both the domestic and imported components. However, inflation is still well-below the NRBT's 6-8% reference range. Retail fuel prices declined over the month in line with declining global oil prices. The declining fuel prices is estimated to have detracted 0.5 percentage points from inflation.

Both the Nominal Effective Exchange Rate (NEER) and the Real Effective Exchange Rate (REER) remain stable over the month. In year ended terms both fell by 1.6% and 2.3%, respectively.

Tonga's overall Overseas Exchange Transactions balance was a \$3.6 million deficit over November compared to a surplus of \$0.6 million in October. The change resulted from higher net outflows in the current account. Although the merchandise trade and services component were slightly unchanged over the month, receipts in the income and transfers component fell faster. Lower net inflows in the capital account also contributed to the overall deficit in the Overseas Exchange Transactions balance. Import payments fell by 0.6% over the month with fewer payments for

construction materials and motor vehicles behind the decline. Exports receipts picked up by 20.8% over the month mainly due to proceeds from the export of squash. Travel receipts rose by 9.9% over the month while remittances picked up by 5.3% from our key source countries. Foreign reserves fell over the month by \$3.6 million to T\$267.9 million, sufficient to cover 8.8 months of imports.

Broad Money rose by 1.2% (T\$4.4 million) over November due to an increase in net domestic assets more than offsetting a fall in net foreign assets. An increase in bank lending over the month supported the rise in net domestic assets while the fall in foreign reserves is reflected in the lower net foreign assets. The increase in broad money is also consistent with the rise in currency in circulation and total domestic demand deposits.

Banking system liquidity remains high, though it fell by 3.3% (T\$4.9 million) over November 2014 to T\$144.3 million. In year ended terms, it increased by 10%. This is the highest annual percentage growth since October 2013.

Bank lending increased by T\$7.7 million over the month due to increased lending to businesses particularly manufacturing and distribution sectors. Other personal loans also increased over the month supported by lower lending rate on other personal loans. In year ended terms, credit growth continues on the rise recording a growth of 9.7% compared to a 4.7% growth in November 2013. Including loans extended by non-banks, credit growth would be 7.0%.

Weighted average interest rate spread remains low, though it increased slightly over the month due to an increase in

weighted lending rates to businesses more than offsetting a fall in weighted deposit rates. The growth in total loans contributed to the higher weighted lending rates, while the decline in total demand and saving interest bearing deposits resulted in the lower weighted deposit rates.

Net credit to government increased by around 8%, reflecting lower government deposits. This is consistent with lower government foreign receipts and higher payments over the month of November which contributes to the fall in foreign reserves over the month.

Supported by developments among Tonga's key trading partners, the NRBT's outlook for a broadly positive domestic growth remains. Banks' credit growth strengthened and weighted average interest rate spread remains low with increasing number of projects in the pipeline to be financed. Banking system liquidity remains high and foreign reserves remain well above the minimum range. Inflation remains within acceptable levels as the pa'anga strengthens against key import currencies and continued lower global oil prices. However, the continuing El Niño warning, less cruise ships to arrive on shore, delay in receiving donor funds for the tourism sector and delay in construction projects are dampening the growth outlook. The existing monetary policy setting therefore is considered appropriate and the NRBT will continue to closely monitor the country's economic developments and financial conditions and to adjust the monetary policy stance if required, to support macroeconomic stability and economic growth.

