

# Monthly Economic Review

## September 2014

Economic growth among Tonga's key trading partners broadly supports domestic activity. The New Zealand dollar depreciated by a further 2.9% over September, easing the inflationary impacts from the imported component. Australia's unemployment rate rose to 6.1% in September suggestive of persistently subdued growth, while the United States unemployment rate has fallen to a six-year low of 5.9%. China's economy grew by 7.3% in the September quarter, down slightly from June's 7.5% growth reflecting an easing real estate market and weak domestic demand. According to the Reserve Bank of Fiji, key local sectors continue to show positive signs for economic growth, particularly sugar production.

Domestic economic activities were positive over the month. Agricultural export volumes grew by 34.6% mainly driven by taro exports and the addition of 'butterkin' squash to Tonga exports. Agricultural export receipts also doubled over the month supporting growth. International air arrivals grew by 4.8%, up by 9.4% from September 2013, suggesting growth in tourism activities. However, a 11.8% decline in domestic air traffic might suggest activities were more concentrated on the main island. Trade activity is expected to strengthen with an 11.8% increase in container registrations driven by a lift of 41.1% in business containers.

The analysis of the Consumption Tax (CT) data, which reflects spending by the formal sector, shows that consumer spending fell by 1.9% in September but remained positive over the year, rising by 1.9%. Vehicle registrations also increased by 18.1% over the month supporting the rise in consumption. CT data suggests positive investment conditions, with business spending growing by 8.6% over the month, a rise of 3.7% over the year. Spending in Construction almost doubled over the month reflecting the commencement of the Ha'apai reconstruction works. Retail and wholesale spending increase markedly in the formal sector, recording growth of 17.3% coinciding with a rise in import payments for wholesale goods.

Headline inflation eased in September 2014 by 1.2%, driven by the imported component. Over the month, the main decline for imported food prices was for meats, fish & poultry category. This was mainly driven by the depreciation in New Zealand dollar, relative to Tongan Pa'anga. Declines in domestic food prices were mostly attributed to decreases in prices of Fruit & vegetables. In year-ended terms, headline inflation rose by 1.1%, down from 2.5% in August. Again, imported component drove the increase, due mainly to rises in food prices and Clothing and shoes. All retail fuel prices fell over the year to September 2014. This decline in retail fuel prices equates roughly to a



0.2 percentage point subtraction from inflation over the year.

The Nominal Effective Exchange Rate (NEER) rose 0.1% over the month while the Real Effective Exchange Rate (REER) fell by 1.3%. Over the year, both the NEER and REER index fell by 1.8% and 2.9%, respectively.

Tonga's overall Overseas Exchange Transactions balance was in deficit over the month of September. The deficit was largely a result of an increase in the current account deficit offsetting a higher capital account surplus. Import payments increased over the month particularly for imports of wholesale goods and motor vehicles. Interest payments on external debt also increased over the month. Exports were particularly good in September for agricultural and marine goods. Travel receipts picked up over the month, and are expected to pick up in the next few months with Christmas approaching. Remittances fell by 12.7% over the month. The rise in net capital inflows over the month resulted from an increase in private capital receipts. Foreign reserves as at end of September 2014 of T\$270.9 million covers 8.8 months of imports, which fell by T\$13 million over the month but still remained well above the NRBT's reference range.

Broad money increased by 1.6% to \$373.2 million in September, driven by an increase in net domestic assets more than offsetting a decline in net foreign assets. The rise in net domestic assets was due to an increase in other non-financial assets. The rise in broad money is counterpart

with an increase in quasi money particularly the saving and term deposits. Banking system liquidity fell a little over the month, underpinned by a decline in foreign reserves. An adequate liquidity margin for prudent lending remains, particularly in short term deposits. Bank lending fell by 0.4% over the month, led by a decline in lending to business sector particularly lending to distribution, tourism and transport sectors. This largely reflected loan write-offs during the month.

In year-ended terms, total bank lending balances rose by 9.1% (T\$23.3m), mainly due to lending to the 'business' and 'housing' sectors. The growth in business loans largely reflects major loans extended to public enterprises. The rise in housing loans is supported by a fall in the housing lending rates. Including loans extended by non-banks, the lending balance increased by 10.1% over the year. New commitments fell slightly over the month mainly due to a decline in commitments to vehicle and 'other' sectors. Meanwhile, the weighted average interest rate spread narrowed over the month as a result of a rise in deposit rates particularly saving and time deposits, and a decline in lending rates.

Net credit to government slightly increased over the month, contributed mainly by a slight decline in deposits. While both government receipts and payments grew strongly over the month, the outcome reflects increased government debt repayments. This outweighs government receipts over the month, which was largely contributed by the transfer of NRBT profit of more than T\$3 million.

Supported by economic growth among Tonga's key trading partners, the NRBT's outlook for a continued domestic recovery remains positive. Bank's credit growth will continue to strengthen as weighted average interest rate spread continues to narrow and also other projects in the pipeline to be financed. Despite the decline in banking system liquidity and foreign reserves, it will remain well above the reference range. Inflation remains within the acceptable levels as the pa'anga strengthens against key import currencies. Given this, the existing monetary policy setting is considered appropriate in the near term.

