



MONTHLY ECONOMIC REVIEW

Vol. 4

No. 8

Month Ended: August 2017

Global growth prospects remained relatively stable in August. Both the Reserve Bank of Australia and the Reserve Bank of New Zealand reported unchanged monetary policy settings. Australia experienced improved economic conditions over the June quarter driven by strong retail sales and growing employment levels. New Zealand experienced strong population growth, increasing incomes, and high housing prices which have been supportive of consumption growth over August. The US economy recorded a 3.1% growth for the June quarter, driven by stronger consumer spending and high business investments. Overall, the outlook remains firmly positive for Tonga's major trading partners.

The local economic activities were vibrant over the month of August. Total agricultural export volumes rose by 335.4 tonnes, reflecting the commencement of the squash season and higher export of cassava. This was supported by a 7.1% growth in lending to the agricultural sector. Ongoing construction activities continued to boost performance in the secondary sector, supported by a 0.7 million kWh rise in electricity consumption. Increase in business loans for manufacturing also supported this sector's expansion. The number of air arrivals rose by 527 passengers benefitting the activities in the tourism sector. The total number of container registrations increased by 377 registrations and 374 vehicles were registered in August, 46.4% and 34.1% higher than the previous month respectively. This echoed an active trade sector and spillover effects to the transportation sector.

As a partial indicator of employment, the total number of job advertisements rose over August 2017 by 25 vacancies but decreased over the year by 104 vacancies.

Monthly headline inflation for August fell by 0.2%. The continuous abundant supply of fruits and vegetables drove the local prices lower, particularly for items such as tomatoes, capsicum and lū. Imported prices however increased due to higher mutton flaps prices, Winfield blue and chicken prices.

Prices	Monthly		Annual	
	Aug-17	Jul-17	Aug-17	Jul-17
Headline Inflation (%)	-0.2	-0.2	5.2	7.1
Domestic prices	-2.0	-2.4	3.9	6.7
Imported prices	1.2	1.5	6.2	7.4

Source: Statistics Department

The annual headline inflation slowed further to 5.2% in August 2017, slightly higher than the Reserve Bank's reference rate of 5%. Imported food prices drove the annual inflation rate for items such as mutton flaps, butter,

sugar, Winfield blue and alcohol. The revised excise duties on certain products that was introduced last month contributed to the rise in imported prices. The short supply of kava-Tonga, seasonality in local produce and higher electricity prices over the year largely contributed to the higher domestic inflation.

	Monthly			Annual	
	Aug-17	Jul-17	% Growth	Aug-16	% Growth
Nominal Effective Exchange Rate Index	91.5	90.9	0.6	90.2	1.4
Real Effective Exchange Rate Index	105.6	105.2	0.3	100.6	4.9

Sources: NRBt

In August 2017, the Tongan Pa'anga appreciated against the NZD and FJD, which resulted in both the Nominal Effective Exchange Rate (NEER) and the Real Effective Exchange Rate (REER) index to slightly rise over the month and year. The rise in the Real Effective Exchange Rate (REER) index also reflected Tonga's higher headline inflation rate relative to its trading partners, which may impact the international competitiveness of the Tongan exports of goods and services.

	Monthly			Annual		
	Aug-17	Jul-17	% Growth	Aug-17	Aug-16	% Growth
OET Receipts (TOP \$ million)	69.2	62.2	11.3	761.9	671.3	13.5
Export receipt	2.5	1.1	119.6	24.9	16.7	49.1
Travel receipts	12.6	11.4	10.1	113.0	85.7	31.9
Private transfers	25.7	23.8	8.0	270.7	234.8	15.3
Others	28.4	25.8	10.1	353.2	334.1	5.7
OET Payments (TOP \$ million)	63.3	60.9	3.9	657.1	591.2	11.1
Import payments	40.0	32.9	21.8	378.8	337.8	12.1
Services payments	14.5	11.1	30.5	142.1	128.2	10.9
Primary Income payments	2.9	2.5	18.0	36.7	18.0	104.1
Others	5.8	14.4	-59.5	99.4	107.2	-7.2

Source: Banking System

Total Overseas Exchange Transaction (OET) receipts rose by 11.3% to \$69.2 million over the month of August 2017. This was largely owing to higher receipts from overseas banks funding their local accounts and supported by receipts of Government budgetary support. In year ended terms, total OET receipts rose by 13.5% to \$761.9 million mainly due to higher inflows of private remittance and travel receipts. Total OET payments slightly increased over the month of August 2017 by 3.9% to \$63.3 as import and services payments were higher. Over the year, total OET payments rose by 11.1% to \$657.1 million, particularly payments for importing of wholesale & retail goods. The overall OET balance for August 2017 recorded a deficit of \$3.9 million. This contributed to the decline in the official foreign reserves to \$405.0 million in August 2017, equivalent to 6.9 months¹ of imports cover, which is above the Reserve Bank's minimum range of 3-4 months.

	Monthly			Annual	
	Aug-17	Jul-17	% Growth	Aug-16	% Growth
Foreign Reserves (\$ in million)	405.0	408.9	-1.0	366.3	10.6
Import Coverage (months)	6.9	7.1		7.2	

Sources: NRBt

¹ Method of calculation changed in February 2017 to include both imports of goods & services (previous method used imports of goods only)



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Broad money (money supply) increased over August, driven by increases in both net foreign assets (commercial banks' foreign currency accounts) and net domestic assets (credit to private sector). Annual growth on broad money is fueled by significant rise in net foreign assets due mainly to the increase in foreign reserves.

Money	Monthly			Annual	
	Aug-17	Jul-17	% Growth	Aug-16	% Growth
Money Supply (\$ in million)	552.3	533.2	3.6	491.0	12.5
Net Foreign Asset	429.0	426.5	0.6	377.9	13.5
Net Domestic Asset	123.4	106.9	15.4	113.4	8.9

Source: Banking System, NRBT

Despite the rise in Statutory Required Deposit ratio from 5% to 10% last month, liquidity in the banking system (reserve money)² increased over August to \$282.9 million. This was due to higher deposits which mainly resulted from receipt of funds for the sale of shares in Tonga Cable Limited. The banks' total loans to deposit ratio slightly fell in August to 75.2% from 76.3% last month, due to an \$18.6 million (3.5%) increase in deposits outweighing a credit growth of \$8.5 million (2.1%). This ratio continues to remain below the 80% loan to deposit ratio target which indicates excess liquidity in the banking system remains and that there is capacity for further lending by banks.

Total banks' lending increased over August as well as over the year to a new high level of \$415.6 million, surpassing the level of lending last month and over the history of banking data. The monthly growth was driven largely by business loans particularly lending to public enterprises, transport, and agricultural sectors. Additionally, lending to households rose as a result of an increase in personal loans. Over the year, lending to businesses increased primarily to public enterprises, wholesale & retail, and services sectors. This continued to support and corresponded to other domestic economic activities evident throughout the year. The lower interest rates from the Government Development Loans have also supported the higher lending to these sectors. Households loans continue to grow over the year. Annual credit growth to August of \$60.4 million (17.0%) was higher compared to an annual credit growth of \$55.2 million (15.7%) in July.

The weighted average interest rate spread widened slightly to 5.680% over August. This was a result of the decline in the weighted average deposit rate outweighing

Lending	Monthly			Annual	
	Aug-17	Jul-17	% Growth	Aug-16	% Growth
Total Lending (\$ in million)	415.6	407.1	2.1	355.2	17.0
Business lending	181.8	176.0	3.3	159.6	13.9
Household lending	232.6	229.9	1.2	194.3	19.7
Other lending	1.2	1.2	0.2	1.3	-7.5

Source: Banking System, NRBT

the decline in the weighted average lending rate. The weighted average lending rate declined over the month due to lower business lending rates for the transport and tourism sectors. Furthermore, weighted average deposit rate over August declined across the board in all deposit categories with term deposit rates decreasing the most. Over the year, the weighted average interest rate spread narrowed, reflecting the low interest rate environments which supported the substantially higher growth in lending to households and businesses.

Interest Rates	Monthly			Annual	
	Aug-17	Jul-17	Growth (bps)	Aug-16	Growth (bps)
Weighted Average Banks Deposit Rate (%)	2.148	2.189	-4.1	2.181	-3.3
Weighted Average Banks Lending Rate (%)	7.828	7.848	-1.9	7.902	-7.4
Weighted Average Interest Rate Spread (%)	5.680	5.659	2.1	5.721	-4.1

Source: Banking System, NRBT

Net credit to Government rose over the month by \$7.2 million, due to a fall in government deposits driven by higher payment obligations. Net credit to Government however fell over the year by \$45.8 million due to receipts of budgetary support funds and improved government revenue collection.

The Reserve Bank's outlook for strong domestic economic activity remains in the medium term. The level of foreign reserves is also expected to remain at comfortable levels supported by expected higher receipts of remittances and foreign aid. This will be partially offset by the projected rise in imports. Upward inflationary pressure remains in the near term, however it is expected to fall below the Reserve Bank's inflation reference rate of 5% per annum in 2017/18. In light of the above developments and that the banking system remained sound, the Reserve Bank Board maintained its current monetary policy measures. The Reserve Bank will remain vigilant and continue to closely monitor for early signs of vulnerability and developments in the domestic and global economy. The Reserve Bank will continue to update its monetary policy setting to maintain internal and external monetary stability and to promote a sound and efficient financial system, in order to support macroeconomic stability and economic growth.

² Sum of currency in circulation, exchange settlement account balances, and required reserve deposits.