



## MONTHLY ECONOMIC REVIEW

Vol. 4

No. 6

Month Ended: June 2017

International developments remained relatively firm across Tonga's major trading partners. The US recorded annual Gross Domestic Product (GDP) growth of 2.6% in the June 2017 quarter, up from a 1.2% growth in the previous quarter. This was due mainly to stronger consumer spending and federal government spending. In addition, the US labour market rebounded in June 2017. This supported the Federal Open Market Committee (FOMC) decision to raise the target rate for its federal fund rate to 1.00–1.25% from 0.75–1.00%. In Australia, inflation eased as consumer prices rose by 1.9% over the year to the June quarter of 2017 compared with 2.1% in the March 2017 quarter. Australia's unemployment rate was steady at 5.6% in June 2017 from last month. The Reserve Bank of Australia (RBA) Board decided to leave the cash rate unchanged at 1.5% to support economic growth. Meanwhile, in New Zealand, inflation rose by 1.7% over the June 2017 quarter, easing from a 2.2% rise in the previous quarter. The unemployment rate slightly fell to 4.8% in the June 2017 quarter from 4.9% in the previous quarter. Despite the mixed movements, positive expectations of growth ahead for all economies remain.

Domestically, partial economic indicators indicated generally positive growth in June. From the primary sector, the total volume of agricultural exports decreased by 49.0 tonnes (6.1%) largely attributed to no export of watermelon during the month compared to the 93.0 tonnes exported in May 2017. According to liaison with stakeholders in the domestic agricultural market, the supply of vegetables and some root crops, except for yam, was relatively more favourable in May compared to June. Marine exports recorded the highest volume of exports for the year so far at 399.8 metric tonnes, as 6 foreign vessels unloaded their catch at Tonga's port. The secondary sector also showed positive activities. Individual housing loans and business construction loans increased by \$2.9 million (1.7%) and \$0.5 million (5.0%) respectively over the month which supported the construction sector. In the tertiary sector, the number of container registrations fell by 45 containers (4.2%) over the month to 1,011 containers. Both private and business container registrations fell by 35 and 10 registrations respectively. Additionally, vehicle registrations declined by 45 vehicles (13.0%). International arrivals, on the other hand, increased by 14.4%, which is attributed to visitors attending the annual church conferences, as well as the whale watching season, supporting the tourism sector and

spillover effects to other sectors such as the transportation and trade sectors.

In the labour market the total number of job advertisements rose by 15 vacancies over the month. This reflected higher recruitment demand in the Services Sector, mainly Public Administration such as the Ministry of Revenue and Customs and Tonga Family Health. However, the total number of job advertisements fell over the year by 25 vacancies. The outlook on job vacancies may be impacted by the government's budget for 2017/18 in the near term.

Headline inflation increased over the month by 0.8% due to a rise in both domestic and imported inflation of 1.0% and 0.7% respectively. This was largely attributed to a further increase in the price of both local and imported food. The price of local fruit and vegetables rose by 4.3%, for items such as capsicum, pele leaves, bananas, and green coconut. Imported food prices rose by 1.4% due mainly to a 2.5% increase in price of meat, fish and poultry. The prices of chicken pieces and mutton flaps rose by 5.4% and 2.4% respectively to an average of \$3.91 and \$14.09 per kilogram respectively. According to a study by the Reserve Bank, this was partly attributed to higher imported value of these goods.

Prices	Monthly		Annual	
	Jun-17	May-17	Jun-17	May-17
<b>Headline Inflation (%)</b>	<b>0.8</b>	<b>0.2</b>	<b>10.3</b>	<b>10.0</b>
Domestic prices	1.0	0.2	8.7	7.8
Imported prices	0.7	0.2	11.7	11.8

Source: Statistics Department

The annual headline inflation edged higher in June 2017 rising by 10.3%. The same period in 2016 recorded a very low annual inflation of 0.1%, which also had lower level of imported and local prices. Imported prices rose by 11.7% over the year contributing 6.5 percentage points to the annual headline inflation. The prices of all imported food categories rose, except for imported fruits and vegetables, and this was led by a 26.6% increase in the price of meat, fish & poultry. This included a rise of 41.5% and 33.5% in the price of mutton flap and chicken pieces respectively. This was followed by a 10.8% rise in the price of other food components which included goods such as sugar whose price rose by 21.6%. The higher prices of imported meat continued to reflect the excise taxes and custom duties imposed on various imported food in July 2016. Similarly, the price of Winfield blue tobacco rose by 29.2%. Additionally, the increase in world oil prices drove the price of fuel higher by 10.1%, diesel and petrol prices rose by 16.0% and



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14.5% respectively. Furthermore, the price of kerosene and liquid petroleum gas increased by 10.8%.

Domestic inflation rose by 8.7% over the year to June 2017 accounting for 3.8 percentage points of the headline inflation. This was driven by the seasonality of local food, rise in electricity price, and the continued short supply of kava-Tonga. The price of local food rose by 10.2% contributing 2.1 percentage points to the overall headline inflation due to the prolonged dry weather in 2017 for growing vegetables compared to the same period in 2016. The increase in oil prices drove the electricity price higher by 22.7%, and kava-Tonga price rose annually by 43.0%.

	Monthly			Annual	
	Jun-17	May-17	% Growth	Jun-16	% Growth
Nominal Effective Exchange Rate Index	90.8	90.2	0.7	90.5	0.3
Real Effective Exchange Rate Index	105.5	104.1	1.3	96.9	8.8

Sources: NRBT

In June 2017, the Australian Dollar (AUD) and New Zealand Dollar (NZD) appreciated against the Tongan Pa'anga (TOP) while the United States Dollar (USD), Chinese Yuan (CNY), Japanese Yen (JPY), British Pound (GBP), Euro (EUR) and Fijian Dollar (FJD) depreciated against the TOP. As a result, both the Nominal Effective Exchange Rate (NEER) index and the Real Effective Exchange Rate (REER) index slightly rose over the month. In annual terms, both the NEER index and the REER index rose. The rise in the REER index 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	
	Jun-17	May-17	% Growth	Jun-17	% Growth
<b>OET Receipts (TOP \$ million)</b>	<b>86.1</b>	<b>71.2</b>	<b>21.0</b>	<b>749.1</b>	<b>14.4</b>
Export receipt	1.7	1.4	18.1	23.9	55.1
Travel receipts	11.3	9.0	25.2	108.3	28.8
Private transfers	24.5	26.7	-8.3	263.8	13.9
Others	48.7	34.1	42.9	353.1	9.1
<b>OET Payments (TOP \$ million)</b>	<b>67.3</b>	<b>55.0</b>	<b>22.4</b>	<b>636.9</b>	<b>12.0</b>
Import payments	39.7	33.7	17.8	367.0	14.0
Services payments	11.9	10.8	11.0	142.4	16.9
Primary Income payments	8.7	1.9	357.7	33.8	103.7
Others	7.0	8.7	-18.8	93.7	-13.4

Total Overseas Exchange Transaction (OET) receipts continued to increase over the month of June 2017, by 21.0% to \$86.1 million. This was mainly driven by an increase in official transfers, mainly grants received by the Government for technical assistance and other current expenditures. In year ended terms, total OET receipts also rose by 14.4% to \$749.1 million which was largely owing to the higher inflows of private remittances

receipts. The celebrations and annual events during the year supported the annual growth in remittances.

Total OET payments increased in June 2017, similar to last month, by 22.4% to \$67.3 million mainly due to higher import and primary income payments. Higher imports payments were mainly for oil imports, whereas the rise in primary income payments was mainly dividend repatriation to overseas shareholders. In annual terms, total OET payments rose by 12.0%, which was attributed to higher imports and services payments, particularly for wholesale & retail goods and freight payments.

	Monthly			Annual	
	Jun-17	May-17	% Growth	Jun-16	% Growth
Foreign Reserves (\$ in million)	407.9	392.3	4.0	354.9	14.9
Import Coverage (months)	7.4	7.2		7.2	

Sources: NRBT

The overall OET balance for June 2017 was therefore a surplus of \$15.6 million. This contributed to the rise in the official foreign reserves to \$407.9 million in June 2017, equivalent to 7.4 months<sup>1</sup> of imports cover, which is still above the Reserve Bank's minimum range of 3-4 months.

Broad money (money supply) continued to rise in June. This was mainly a result of an increase in net foreign assets, more specifically, higher foreign reserves. Net domestic assets also contributed to the monthly increase driven by an increase in net domestic credit. Over the year, broad money increased solely as a result of a significant rise in net foreign assets, which again was contributed by the increase in foreign reserves. This had offset the decline in net domestic assets. The yearly increase in broad money was 13.7% close to the Reserve Bank's forecast<sup>2</sup> for June 2017 of 14.0%.

Money	Monthly			Annual	
	Jun-17	May-17	% Growth	Jun-16	% Growth
Money Supply (\$ in million)	534.9	517.6	3.3	470.5	13.7
Net Foreign Asset	428.1	413.0	3.7	362.5	18.1
Net Domestic Asset	106.9	104.7	2.0	108.3	-1.3

Source: Banking System, NRBT

Liquidity in the banking system (reserve money)<sup>3</sup> fell over June to \$283.8 million. This was mainly a result of withdrawal of cash by the commercial banks from the Reserve Bank's vault. The banks' total loans to deposit

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

<sup>2</sup> This forecast was conducted in August 2016

<sup>3</sup> Sum of currency in circulation, exchange settlement account balances, and required reserve deposits.



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ratio increased in June to 75.4% from 74.5% last month due to the credit growth of \$6.8 million (1.7%) outweighing the \$2.9 million (0.5%) rise in deposits. Nevertheless, this ratio continued 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 the banks.

Total banks' lending continued to increase over June and over the year to a new record high of \$404.5 million surpassing the level set last month. This continued to be driven by increased lending to both households and businesses. Over June, growth in loans to the wholesale & retail, manufacturing, and construction sectors contributed largely to the rise in lending to businesses of \$3.5 million (2.1%). Housing loans continued to drive higher lending to households which rose by \$2.4 million (1.1%) over the month and \$41.9 million (22.5%) over the year. Annually, vehicle loans and other personal loans also contributed to the rise in lending to households. Lending to businesses rose \$9.4 million (5.7%) over the year driven by growth in loans made to the wholesale & retail, services, and manufacturing sectors. This coincided and supports other evident increases in domestic economic activities throughout the year. Additionally, the lower interest rates from the Government Development Loans have also supported the higher lending to these sectors. Credit growth over the year to June of \$52.2 million (14.8%) was noticeably higher compared to an annual credit growth in May of \$49.0 million (14.1%). This growth is very close to the Reserve Bank's estimated credit growth of 15.0%<sup>4</sup> to be achieved at the end of 2016/17.

Lending	Monthly			Annual	
	Jun-17	May-17	% Growth	Jun-16	% Growth
Total Lending (\$ in million)	404.5	397.7	1.7	352.3	14.8
Business lending	174.2	170.7	2.1	164.7	5.7
Household lending	225.8	225.8	0.0	186.3	21.2
Other lending	1.2	1.2	0.0	1.2	0.2

Source: Banking System, NRB

The weighted average interest rate spread widened in June to 5.7%. This resulted from a decline in the weighted average deposit rate, more specifically, demand deposit and saving deposit rates whilst the weighted average lending rate rose slightly. The increase in the weighted average lending rate over June driven by higher lending rates to both businesses and households. The higher lending rates to households applied for housing, vehicles, and other personal loans. Meanwhile, higher lending rates to businesses were for

the construction, trade, and utilities sectors. The increase in the weighted average interest rate spread over the year was due to a decrease in the weighted average deposit rate offsetting a decrease in the weighted average lending rate. All deposit rates declined over the year with saving deposit rates falling the most. This coincides with the significant increase in deposits over the year. Lending rates fell driven by lower rates for household and business loans. More specifically, lower rates for housing loans and vehicle loans declined as well as lower rates for almost all business loans particularly loans to the manufacturing, agricultural, and trade sectors. This supports the substantially higher growth in lending to households and businesses over June and over the year.

Interest Rates	Monthly			Annual	
	Jun-17	May-17	Growth (bps)	Jun-16	Growth (bps)
Weighted Average Banks Deposit Rate (%)	2.134	2.148	-1.5	2.249	-11.6
Weighted Average Banks Lending Rate (%)	7.834	7.830	0.4	7.879	-4.5
Weighted Average Interest Rate Spread (%)	5.700	5.682	1.9	5.629	7.1

Source: Banking System, NRB

Net credit to Government continued to fall over the month by \$11.9 million and fell over the year by \$40.5 million. This was due mainly to a rise in government deposits supported by the receipts of the budgetary support and government grant funds, as well as 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 and this will be partially offset by the projected rise in imports. Upward inflationary pressure remains in the near term due to the impact of the increase in custom duty and excise tax effective on 1<sup>st</sup> July 2016; 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 early signs of vulnerability and developments in the domestic and global economy, and 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.

<sup>4</sup> This forecast was conducted in August 2016