



MONTHLY ECONOMIC REVIEW

Vol. 5

No. 5

Month Ended: May 2018

Overseas economies supporting domestic growth

The global economy was reported to have experienced positive performances in the first quarter of the year. This was attributed to improvements in emerging market economies offsetting the slowdown in advanced economies. More specifically, the United States experienced weaker than expected growth reflecting the effects of tax cuts on consumers and businesses. Tonga's other trading partners experienced otherwise such as Australia and New Zealand. Australia's economy performed better than expected reporting a 3.1% annual increase in GDP at the end of the 2018 first quarter. This was driven by strong growth in mining commodities exports.

Strong domestic economic activities

Domestically, partial economic indicators were mixed but broadly positive overall. The performance of all sectors of the domestic economy was favorable. Lower domestic prices recorded for food particularly, taro, sweet potatoes, head cabbage and carrots reflected abundant supply due to its harvesting season that was in progress. The total export volume of agricultural products however declined over the month mainly due to lower exports of yam and cassava. The on-going construction activities continued to boost the performance of the secondary sector, which was supported by a 0.3% growth in individual housing loans. Banks' lending to manufacturing businesses also grew by 2.6% over the month. Electricity production and consumption also increased over the month. Several events that took place during the month including annual church conferences and special Sundays for the family improved performance in the tertiary sector. The higher import payments and businesses repatriation of funds to their head offices reflected the lively domestic economic activities. Banks' total lending (including Government Development Loans (GDL)) also rose by 0.8%. Total air arrivals increased by 52.3% which coincided with a \$2.1 million rise in travel receipts. In addition, the total number of container registrations increased by 105 (11.2%), solely due to a 27.3% increase in business containers which indicates a vibrant trade sector.

As a partial indicator of employment, the total number of job advertisements declined by 31 vacancies over the month mainly due to lower government vacancies. The intention to fill vacant positions in the government before the end of the financial year had boosted the number of vacancies in the previous month. However, in the 12 months to May, the total number of job advertisements rose by 13 vacancies reflected a rising demand for labour in Tonga. In filling these vacant positions it will help to reduce Tonga's unemployment rate¹.

Inflationary pressure continues

Monthly headline inflation slowed to 0.1% in May 2018 from 0.4% last month. This was due mainly to domestic prices

declining despite the imported prices rising over the month. The lower domestic prices was attributed to a decline in the prices of local produce mainly root crops and vegetables. Imported prices however rose by 0.3%, which was slightly higher than the 0.1% rise in April, as the respective monthly average price for petrol and diesel rose over the month by 3 cents and 5 cents per litre.

Table 1: Inflation Rates

Prices	Monthly		Annual	
	May-18	Apr-18	May-18	Apr-18
Headline Inflation (%)	0.1	0.4	9.4	9.6
Domestic prices	-0.1	0.7	12.7	13.2
Imported prices	0.3	0.1	6.9	6.8

Source: Statistics Department

The annual headline inflation still remained high at 9.4% in May, although it slowed from 9.6% last month. This was due mainly to domestic prices being at a very low level in May 2017. Domestic inflation increased over the year to May 2018 by 12.7% contributing 5.6 percentage points to the overall headline inflation. Seasonality and damages to fruits and vegetables caused by TC Gita resulted in lower supply of these food items. The price of vegetables remained stable at \$3.00 per bunch but with smaller quantity. The prices of local fruits and vegetables which rose considerably over the year included tomato, capsicum, green

Table 2: Items contributing to domestic inflation

Items (\$ per kg)	May-18	Annual	
		May-17	% Growth
Tomatoes	\$20.97	\$10.74	95.3
Capsicum	\$28.80	\$9.96	189.2
H/Cabbage	\$8.61	\$4.42	94.8
Carrots	\$9.29	\$4.72	96.8
Banana ripe	\$6.20	\$2.45	153.1
Pawpaw	\$3.53	\$1.60	120.6
Coconut (green)	\$1.93	\$1.01	91.1
Kava-Tonga	\$140.00	\$100.00	40.0
Coral aggregates	\$120.00	\$85.00	41.2

Sources: Statistics Department

coconuts, ripe banana and pawpaw. Overall, the price of fruits and vegetables has therefore increased over the year by 44.5%. Other local prices that contributed to the overall headline inflation included kava-Tonga and house maintenance goods.

The imported component of inflation contributed 3.8 percentage points to the overall headline inflation. This was due to higher prices of imported food, tobacco, and fuel.

Exchange Rates remain competitive

In May 2018, the Nominal Effective Exchange Rate (NEER) index slightly rose due to the depreciation of the NZD against the TOP which outweighed the appreciation of both the USD and AUD against the TOP.

Table 3: Exchange Rates

	Monthly			Annual	
	May-18	Apr-18	% Growth	May-17	% Growth
Nominal Effective Exchange Rate Index	90.5	90.4	0.01	90.8	-0.3
Real Effective Exchange Rate Index	104.1	103.7	0.4	103.6	0.5

Sources: NRBT

The Real Effective Exchange Rate (REER) index also rose over the month and over the year which reflected Tonga's higher headline inflation rate relative to its trading partners,

¹ Unemployment rate of 1.1% refer to not working, available & looking for work, 16.4% refer to not working, available & willing to work and 34.8% refer to including subsistence workers



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which may impact the international competitiveness of the Tongan exports of goods and services.

Foreign Reserves remained comfortable

Table 4: Foreign Reserves

	Monthly			Annual	
	May-18	Apr-18	% Growth	May-17	% Growth
Foreign Reserves (\$ in million)	441.9	445.9	-0.9	392.3	12.6
Import Coverage (months)	7.8	7.9		7.1	

Sources: NRBT

In May 2018, the overall Overseas Exchange Transaction (OET) balance recorded a deficit of \$4.0 million which was reflected in a decline in the official foreign reserves to \$441.9 million. This is equivalent to 7.8 months² of import cover.

OET Payments increased slightly more than the OET receipts

The Balance of Payments (OET) deficit widened over the month which was attributed mainly to higher current account payments. This was driven by repatriation of funds by businesses to their head offices abroad and an increase in total import payments mainly payments for the import of wholesale & retail goods. Total receipts also rose over the month due to higher current account receipts reflecting a \$9 million rise in remittances, and supported also by higher travel and telecommunication receipts. Capital and financial accounts receipts however were lower due to a decline in private capital receipts for construction purposes and lower interbank receipts.

Table 5: Overseas Exchange Transactions

	Monthly			Annual		
	May-18	Apr-18	% Growth	May-18	May-17	% Growth
Overall Balance	-4.0	-1.8	122.8	49.6	61.6	-19.5
Current Account	-4.9	-4.9	0.5	2.7	46.8	-94.2
Merchandise Trade	-36.0	-30.3	18.9	-388.9	-332.6	16.9
Services	-3.4	0.7	-577.2	39.2	23.5	66.8
Income	0.4	1.2	-65.3	-12.4	-7.4	68.7
Transfers	34.0	23.5	45.1	364.9	363.3	0.4
Capital Account	2.6	2.8	-5.8	41.7	27.0	54.2
Financial Account	-1.7	0.3	-687.8	5.2	-12.1	-143.2

Source: Banking System

Over the year, the OET balance recorded surplus of \$49.6 million due to surpluses in all accounts with capital account recording the highest surplus of \$41.7 million. This however was a lower overall surplus due mainly to the widening in the merchandise trade deficit over the year. The current account receipts increased over the year due to higher remittances and telecommunication receipts.

Net domestic credit drives increase in broad money

Table 6: Broad Money

	Monthly			Annual	
	May-18	Apr-18	% Growth	May-17	% Growth
Broad money (\$ in million)	561.5	547.1	2.6	517.6	8.5
Net Foreign Assets	460.4	461.3	-0.2	413.0	11.5
Net Domestic Assets	101.3	86.1	17.7	104.7	-3.2

Source: Banking System, NRBT

The decline in Government deposits, due to the payout of the Government's Tropical Cyclone Gita recovery assistance to non-government schools, drove the rise in net

domestic assets and broad money in May 2018. Net foreign assets fell over May reflecting the decline in the foreign reserves. The yearly movement for broad money was due yet again to a significant rise in the foreign reserves leading the rise in net foreign assets.

Liquidity remains high

Table 7: Reserve money

	Monthly			Annual	
	May-18	Apr-18	% Growth	May-17	% Growth
Reserve money (\$ in million)	298.4	292.2	2.1	284.8	4.8

Source: Banking System, NRBT

Liquidity in the banking system (reserve money) increased over May. This was driven solely by higher currency in circulation to meet public demands for cash. The banks' total loans to deposit ratio slightly decreased to 75.2% from 76.0% last month, reflecting a larger increase in total deposits than in total loans. This continued to remain below the 80% minimum loan to deposit ratio which indicates excess liquidity in the banking system and that there is capacity for further lending by the banks.

Credit growth continues

Table 8: Total lending (including GDL)

	Monthly			Annual	
	May-18	Apr-18	% Growth	May-17	% Growth
Total Lending (\$ in million)	448.2	444.8	0.8	397.7	12.7
Business lending	201.5	199.0	1.3	170.7	18.1
Household lending	245.9	245.0	0.4	225.8	8.9
Other lending	0.851	0.861	-1.2	1.20	-28.9

Source: Banking System, NRBT

Total banks' lending increased over May and over the year due mainly to a growth in business loans. Business loans rising over May were due to more loans extended to the transport, manufacturing, and fisheries sectors whilst the growth over the year resulted from more loans to the wholesale & retail, transport, and construction sectors. In addition, household loans increased over the month and year ended May due mainly to growth in housing loans.

The continued positive credit growth from previous months reflects the continued higher demand for credit and ability to borrow, which is supported by the ongoing domestic economic activities evident throughout the month of May and the year. The GDL scheme provided low interest rates which had also partially supported credit growth.

Weighted average interest rate spread widens

The weighted average interest rate spread widened further over May and over the year. The weighted average lending rate rose over the month and over the year mainly due to higher household lending rates for housing and other personal loans and similarly business lending rates increased for some sectors namely agriculture, manufacturing, and tourism. The weighted average deposit rate, however, declined over May and over the year due to a fall in demand and term deposit rates.

² Method of calculation changed in February 2017 to include imports of both goods & services (previous method used imports of goods only)



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Table 10: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	May-18	Apr-18	Growth (bps)	May-17	Growth (bps)
Weighted Average Banks Deposit Rate (%)	2.114	2.122	-0.8	2.148	-3.4
Weighted Average Banks Lending Rate (%)	7.904	7.879	2.5	7.830	7.4
Weighted Average Interest Rate Spread (%)	5.790	5.757	3.3	5.682	10.8

Source: Banking System, NRBT

Net credit to Government increased over the month due to a fall in Government deposits. However, net credit to Government declined over the year, due mainly to a rise in Government deposits which was supported by receipts of cyclone relief funds, grants and project funds, budgetary support as well as improved government revenue collection during the year.

Poverty Alleviation through improved access to finance

Annually, both deposits and loans increased indicating the active financial inclusion policies of the banks. In addition, total access points in the banking system rose making financial services more widely accessible. The total access points³ in the banking system increased by 332 to 538 access points as recorded in the latest available data as of June 2017. This was mainly due to more ATM and EFTPOS⁴ machines installed around the country by the banks. Similarly, based on the latest available data, loans to Micro, Small and Medium enterprises (MSMEs) increased by \$6.7 million (56.0%) over the year ended June 2017. This was largely contributed by higher lending to MSMEs in the wholesale and retail, services and agriculture sectors. The tourism and fisheries sectors also noted increases which contributed to the overall rise in lending to the MSMEs. Work is in progress to obtain updated data on access to finance.

Financial Inclusion policies aim to improve access to basic financial services for promoting inclusive economic growth.

This includes savings, credit, and payment systems being more accessible and affordable for all. Furthermore, the Reserve Bank targets to reduce the 34% portion of the unbanked population by 10% in 2020. The banks have their own respective programs which will assist in reaching this target.

The Reserve Bank will continue to collect quality data and develop policy solutions to address the gaps in financial services which includes exploring digital financial services as an avenue to increase access points and ensure financial services are more accessible in rural and remote areas.

Outlook

The 2017/18 financial year is drawing to an end and the Reserve Bank still expects Tonga's economic growth to remain above 3% for 2017/18. The level of foreign reserves remained at comfortable levels and is expected to remain above the 3 - 4 months of import cover in the near term supported by higher receipts of remittances and foreign aid. The Government's external loan repayments and the projected rise in imports will put pressure on the level of foreign reserves. Inflation is anticipated to fall below the Reserve Bank's inflation reference rate of 5% per annum at the end of 2018. The banking system is expected to continue to remain strong. In light of the above, the Reserve Bank maintained its current monetary policy measures and will continue to remain vigilant, closely monitor developments in the domestic and global economies and may change its monetary policy setting to support its monetary policy objectives.

³ This refers to the number of branches, agents, EFTPOS, and ATM

⁴ Automated Teller Machine (ATM) and Electronic Funds at Point Of Sale (EFTPOS)