



### Global economy remains favourable

Development amongst Tonga's major trading partners remained positive over September. Reflecting the strength in the US economy, the Federal Reserve raised its federal funds rate by 25 basis points to 2.25%. Economic growth in Australia and New Zealand was stronger than anticipated in the June quarter. Australia's growth was fueled by consumer spending whilst the pick-up in New Zealand's growth was a result of stronger activity in the agriculture and service industry sectors. Both central banks left their official interest rates unchanged at 1.5% and 1.75%, respectively.

### Sectoral performance slowed over the month

Partial domestic economic indicators suggest a slower pace of growth in September 2018 although growth remains positive on an annual basis. Total agricultural export volumes declined over the month due to lower volume of exported root crops. The ongoing squash season which began in August will continue to contribute to higher agricultural export volumes in the upcoming months. In year ended terms, agricultural exports rose by 487.1 tonnes due mainly to favourable squash season. The domestic agricultural market however reported the volume of available crops for local sale was estimated at 249 tonnes with root crops such as taro and cassava increasing over the month. Activities in the secondary sector remained positive, supported by a rise in business loans for manufacturing and individual housing loans. The total number of container registrations declined in September, a similar trend to previous year. Total container registrations increased over the year, consistent with a \$26.0 million rise in import payments (excluding oil). The number of international air arrivals fell over the month but increased over the year.

Consumption activity slowed over the month reflected by a decline in the consumption tax collected in September 2018. This corresponds with a \$3.9 million fall in total remittances which outweighed a \$0.3 million increase in personal loans. Consumption spending is expected to pick up in the coming months leading up to the festive season, on the optimistic outlook for remittance receipts, and the continuous increase in new loan commitments to households.

### El Niño prediction for Tonga remains

The average rainfall recorded in September 2018 was favorable for almost all of Tonga except Ha'apai and Fua'amotu stations. The Tonga Meteorological Service in its latest climate update<sup>1</sup> indicated that there is approximately an 80% chance of El Niño occurring in 2018. Below average rainfall is expected over the next 6 months. This may have negative implications on the primary sector and the domestic food supply.

### Job vacancies declined over the month

The total number of job advertisements<sup>2</sup> declined over the month by 44 job vacancies but rose over the year by 160 vacancies. This was due to a significant decline in the advertised job vacancies for the public sector.

### Annual headline inflation remains above the 5% reference rate

Headline inflation rose over the month by 0.7%. Both the domestic and imported prices increased. Domestic inflation was solely driven by local food prices for root crops, vegetables and fruits. Prices of various imported commodities rose over the month for food items, tobacco, liquid petroleum gas, and fuel.

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Sep-18	Aug-18	Sep-18	Aug-18
Headline Inflation (%)	0.7	-0.6	6.5	5.7
Domestic prices	0.9	0.1	10.9	8.4
Imported prices	0.6	-1.1	3.3	3.6

Source: Statistics Department

The annual headline inflation rose to 6.5% from 5.7% in August 2018 and a 5.8% in September 2017. Domestic inflation rose by 10.9% attributed to the low prices last year.

Higher prices in local commodities over the year were noted for food, kava-Tonga, household supplies and house maintenance goods. Annual imported inflation increased by

Table 2: Items contributing to annual domestic inflation

Items (\$ per kg)	Monthly			Annual	
	Sep-18	Aug-18	Change	Sep-17	Change
Tuna	\$16.00	\$16.00	\$0.00	\$13.00	\$3.00
Watermelon	\$3.26	\$3.27	-\$0.01	\$1.39	\$1.87
Capsicum	\$10.93	\$7.94	\$2.99	\$9.34	\$1.59
Carrots	\$4.01	\$4.04	-\$0.03	\$2.70	\$1.31
Lu	\$6.41	\$9.75	-\$3.34	\$5.24	\$1.17
Pele	\$2.70	\$3.92	-\$1.22	\$1.65	\$1.05
Tomatoes	\$2.85	\$3.81	-\$0.96	\$1.84	\$1.01
Eggs	\$17.38	\$17.38	\$0.00	\$16.38	\$1.00
Coconut (dry)	\$1.59	\$1.47	\$0.12	\$0.83	\$0.76
Manioke	\$1.20	\$1.09	\$0.11	\$0.50	\$0.70
Kumala	\$2.90	\$2.62	\$0.28	\$2.62	\$0.28
Coconut (green)	\$1.64	\$1.82	-\$0.18	\$1.40	\$0.24

Source: Statistics Department

3.3% due to higher prices for petroleum, tobacco, clothing supplies and cosmetics & toiletries.

### Exchange Rates remained relatively stable

Table 3: Exchange Rates

	Monthly			Annual	
	Sep-18	Aug-18	% Growth	Sep-17	% Growth
Nominal Effective Exchange Rate Index	92.2	91.5	0.8	91.9	0.4
Real Effective Exchange Rate Index	108.3	107.5	0.8	104.6	3.6

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) index slightly rose in September due to the depreciation of all major currencies against the TOP except the GBP. The Real Effective Exchange Rate (REER) index also increased slightly reflecting the rise in headline inflation over the month. Furthermore, the

Table 4: Bilateral Exchange Rates

	Sep-18	Aug-18	Sep-17
USD/TOP	0.4390	0.4377	0.4608
AUD/TOP	0.6086	0.6030	0.5868
NZD/TOP	0.6633	0.6590	0.6372
FJD/TOP	0.9269	0.9203	0.9389
JPY/TOP	49.7782	48.6088	51.8077
GBP/TOP	0.3355	0.3365	0.3430
EUR/TOP	0.3767	0.3753	0.3910
CNY/TOP	3.0248	2.9958	3.0708

Source: National Reserve Bank of Tonga

<sup>1</sup> Issued by the Ministry of Meteorology, Energy, Information, Disaster Management, Environment, and Climate Change & Communication on 8<sup>th</sup> November

<sup>2</sup> Based on data collected by the Reserve Bank



REER increased over the year coinciding with Tonga's higher headline inflation rate in comparison to its trading partners.

### Level of foreign reserves dropped

As expected, the overall deficit balance in the Overseas Exchange Transactions (OET) widened over the month by \$22.8 million. This resulted largely from higher government payments and import payments. Consequently, the official foreign reserves therefore declined significantly, yet remained comfortable and sufficient to cover for 7.3 months of import coverage.

Table 5: Foreign Reserves

	Monthly			Annual	
	Sep-18	Aug-18	% Growth	Sep-17	% Growth
Foreign Reserves (\$ in million)	452.2	475.0	-4.8	403.0	12.2
Import Coverage (months)	7.3	7.7		7.3	

Source: National Reserve Bank Tonga

The higher current account deficit in September was attributed to higher payments for imports of oil and interest payments on loans. While higher payments were recorded, the receipts from private transfer and services decreased. The deficit in the financial account stemmed from the commencement of the principal government loan repayment to the Export-Import (EXIM) Bank of China.

Table 6: Overseas Exchange Transactions

	Monthly			Annual		
	Sep-18	Aug-18	% Growth	Sep-18	Sep-17	% Growth
<b>Overall Balance</b>	<b>-22.8</b>	<b>-1.5</b>	<b>1430.7</b>	<b>49.1</b>	<b>39.3</b>	<b>25.1</b>
<b>Current Account</b>	<b>-16.9</b>	<b>-5.7</b>	<b>197.8</b>	<b>1.7</b>	<b>41.1</b>	<b>-95.9</b>
Merchandise Trade	-40.9	-36.7	11.4	-398.2	-354.7	12.3
Services	0.4	2.2	-81.3	20.1	39.8	-49.4
Income	-1.0	1.9	-151.9	1.4	-21.5	-106.4
Transfers	24.6	27.0	-8.7	378.4	377.5	0.2
<b>Capital Account</b>	<b>2.9</b>	<b>2.4</b>	<b>21.8</b>	<b>37.9</b>	<b>34.1</b>	<b>11.3</b>
<b>Financial Account</b>	<b>-8.8</b>	<b>1.8</b>	<b>-589.9</b>	<b>9.5</b>	<b>-35.9</b>	<b>-126.6</b>

Source: Banking Systems

Annually, the surplus in the overall OET balance increased due to surpluses in all accounts. The surplus in the capital account was the largest contributor owing to higher official grants for investment projects or capital expenditures mainly for government constructions. The financial account recorded a surplus following a deficit in the previous year, due mainly to higher interbank transfers. The current account surplus however, was lower than that of the previous year led by the payments for wholesale & retail goods.

### Broad money declined

Table 7: Broad Money

	Monthly			Annual	
	Sep-18	Aug-18	% Growth	Sep-17	% Growth
Broad money (\$ in million)	595.2	606.0	-1.8	549.7	8.3
Net Foreign Asset	470.1	494.1	-4.8	419.0	12.2
Net Domestic Asset	125.5	112.2	11.8	131.0	-4.3

Source: Banking System, National Reserve Bank of Tonga

A decrease in government deposits to finance its loan repayments during the month reflected an increase in net domestic assets as net credit to government increased, and a fall in net foreign assets coincides with the drop in foreign reserves. However, in year ended terms, net foreign assets rose on the increase in foreign reserves and resulted in the increase in broad money. The receipts of budgetary support, grants and cyclone relief funds from development

partners and higher remittances during the year contributed to this annual growth.

### Liquidity remains in Excess

Table 8: Reserve money

	Monthly			Annual	
	Sep-18	Aug-18	% Growth	Sep-17	% Growth
Reserve money (\$ in million)	323.6	334.2	-3.2	283.0	14.3

Source: Banking System, National Reserve Bank of Tonga

The banking system remained sound in September 2018 as banks maintained a strong capital position, supported by adequate profits and low level of non-performing loans. Lower deposits by the commercial banks to the Reserve Banks' vault contributed to a decline in reserve money. The significant decline in deposits led to a rise in the banks' total loans to deposit ratio from 71.5% in the previous month to 72.9% this month. This ratio continued to remain below the 80% minimum loan to deposit ratio which indicates excess liquidity remains and that there is capacity for further lending by the banks.

### Lending to household drove monthly rise

Table 9: Total Lending

	Monthly			Annual	
	Sep-18	Aug-18	% Growth	Sep-17	% Growth
Total Lending (\$ in million)	459.0	457.5	0.3	417.0	10.1
Business lending	205.7	205.7	0.0	180.8	13.8
Household lending	252.7	251.1	0.6	235.1	7.5
Other lending	0.7	0.7	0.6	1.06	-33.6

Source: Banking System, National Reserve Bank of Tonga

Over the month of September 2018, total banks' lending rose which resulted from an increase in housing loans, personal and vehicle loans. The consistent demand for housing has supported the increase in housing loans. Business and other lending on the other hand remained stable. Over the year, business loans for the wholesale & retail sector increased supported by the rise in container registrations by 575 containers and the 16.9% increase in import payments for wholesale & retail goods. Increased loans for the tourism, professional & other business, fisheries and transport sectors also supported the annual growth. Similarly, housing loans continued to rise over the year. Low interest rates from the Government Development Loans partially supported the higher lending in the business sectors. This coincided with strong domestic economic activities evident throughout the year.

### Weighted average deposit rate decreased

Table 10: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Sep-18	Aug-18	Growth (bps)	Sep-17	Growth (bps)
Weighted Average Banks Deposit Rate (%)	1.978	1.992	-1.4	2.128	-15.0
Weighted Average Banks Lending Rate (%)	8.077	8.076	0.1	7.851	22.6
Weighted Average Interest Rate Spread (%)	6.099	6.084	1.5	5.723	37.6

Source: Banking System, National Reserve Bank of Tonga

The decline in demand and term deposit rates pushed the weighted average deposit rates lower over the month and thus widened the weighted average interest rate spread. Weighted average lending rates however slightly rose over the month mainly for manufacturing and fisheries loans. Similarly, the weighted average interest rate spread widened over the year due to the increase in weighted average lending rates mainly on business loans for mining & quarrying, agriculture and manufacturing sectors. The



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lower term and demand deposit rates supported the decline in weighted average deposit rates.

### Outlook

Given the recent developments, the growth outlook for Tonga continue to remain positive. The level of foreign reserves is also expected to remain at comfortable levels, supported by expected receipts of budgetary support and grant funds from development partners and higher receipts of remittances. This will be partially offset by the anticipated

increase in imports and the Government's external loan repayments. Inflation is expected to fall below the Reserve Bank's inflation reference rate of 5% per annum at the end of 2018. The Reserve Bank will continue to closely monitor developments in the domestic and global economies to ensure financial and macroeconomic stability are maintained and to change its monetary policy setting where necessary to support its monetary policy objectives.