

IMF WEO¹ indicates continued global slowdown

According to the IMF's latest WEO in October 2019, they report that global performance has been the slowest since the Global Financial Crisis. As such, global economic growth for 2019 is revised downwards to 3.0% from the 3.3% projection in April 2019 WEO. This mostly revolves around the continuous trade uncertainties between the US and China. Tonga's major trading partners, namely, the US, Australia, and New Zealand, all experienced slower than expected growth during October. Similarly, this stemmed from weakening business confidence, and thus investments.

Mixed outcomes in domestic activities

Partial data shows positive trends in the primary sector. Lending to the agricultural sector rose by \$0.7 million (5.6%) over the month and \$1.2 million (10.8%) over the year to October 2019, mostly to agricultural exporters. Proceeds from agricultural exports were maintained at \$0.9 million while marine export proceeds rose by \$0.2 million (20.2%) during the month. Export proceeds also performed positively over the year, with a rise in receipts for marine exports of \$3.2 million (52.4%) and \$0.6 million (6.0%) for agricultural exports. Domestic food prices were also cheaper than it was a year ago, specifically for root crops and kava reflecting better harvesting seasons this year.

Performance in the industry sector was mixed. Individual housing loans slightly declined in October by \$0.4 million (0.2%), however, it continued to increase over the year by \$4.7 million (2.3%) supporting the construction sector. Additionally, new commitment loans for October was \$2.3 million for individual housing and \$0.8 million for manufacturing indicating future investment prospects in the construction and manufacturing sectors. This may also have spillover benefits to the mining and quarrying sector. Payments for imports of construction materials also rose during the month by \$0.9 million (54.5%). Meanwhile, the utility sector signaled some price rises commencing with the waste authority fees in October and electricity tariffs in November.

Similarly, the tertiary sector performance was also mixed. In October total air arrivals declined by 550 passengers (5.7%), despite the number of flights rising to 111 flights (4.7% increase). 2 cruise ships also arrived during the month coinciding with the \$0.4 million (3.4%) rise in travel receipts, benefitting the tourism sector. Container registrations decreased by 394 (30.6%) over the month as both private and business container registration declined. This coincides with the monthly decline in total import payments of \$1.6 million (4.1%). Vehicle registrations, however, slightly rose to 295 vehicles (2.8% increase), mostly for heavy and other light vehicles. The measles outbreak that started in October has escalated, leading to the cancellation of schools and major events such as

prize-giving ceremonies, reunions, and other scheduled events, which may contribute to slowing economic activities in the upcoming months.

Partial indicator of employment remained positive

The Reserve Bank's survey on job advertisements showed that advertised vacancies continue to rise to 44 vacancies in October compared to 42 vacancies in the previous month, with the majority for public administration. These work opportunities may contribute to lower unemployment rates.

Headline inflation slowed in October

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Oct-19	Sep-19	Oct-19	Oct-18
Headline Inflation (%)	0.5	-0.1	0.2	6.2
Domestic prices	0.9	-0.7	-1.3	8.1
Imported prices	0.2	0.4	1.5	4.8

Source: Statistics Department

Headline inflation rose by 0.5% over the month. Both domestic and imported prices increased by 0.9% and 0.2%, respectively. Domestic inflation was driven by higher prices of local food such as root crops, vegetables, seafood and eggs, and garbage collection services. Prices of various imported commodities' also rose over the month and was driven by the increase in fuel prices, personal care services, and imported food items such as mutton, apples, sugar, and flour.

Table 2: 'Average prices of selected domestic items'

Items (\$ per kg)	Unit	Monthly			Annual	
		Oct-19	Sep-19	Change	Oct-18	Change
Kava	1 kg	\$100.00	\$105.00	-\$5.00	\$142.50	-\$42.50
Octopus	1kg	\$16.11	\$14.89	\$1.22	\$21.65	-\$5.54
Carrots	1 kg	\$1.91	\$1.82	\$0.09	\$6.25	-\$4.34
Lu	1 kg	\$5.09	\$5.40	-\$0.31	\$6.89	-\$1.80
Yams-late	1kg	\$3.07	\$2.34	\$0.73	\$4.13	-\$1.06
Yams-early	1kg	\$6.06	\$5.95	\$0.11	\$6.89	-\$0.83
Kumala	1 kg	\$1.75	\$2.00	-\$0.25	\$2.55	-\$0.80
Talo-Futuna	1 kg	\$1.55	\$1.39	\$0.16	\$1.83	-\$0.28
Cassava	3 kg	\$1.07	\$1.02	\$0.05	\$1.22	-\$0.15
Sausages	2 kg	\$8.26	\$8.26	\$0.00	\$8.30	-\$0.04

Source: Statistics Department

The annual headline inflation slowed further by 0.2% in October 2019 compared to 0.4% in September and 6.2% inflation in October 2018 owing mostly to declining domestic prices. Domestic prices declined over the year by 1.3%, attributing to prices of kava-Tonga, Tongan tobacco, electricity, and local food prices such as root crops, vegetables, eggs and seafood (octopus). This outweighed the 1.5% rise in import prices over the year. Higher imported prices were noted for alcohol, tobacco, and food items such meat, onions, flour and sugar. Fuel prices are still lower relative to the same last year.

¹ International Monetary Fund's World Economic Outlook for October 2019

Competitive exchange rates

Table 3: Effective Exchange Rates

	Monthly			Annual	
	Oct-19	Sep-19	% Growth	Oct-18	% Growth
Nominal Effective Exchange Rate Index	92.3	92.6	-0.3	92.4	-0.1
Real Effective Exchange Rate Index	108.5	108.7	-0.1	110.0	-1.3

Source: National Reserve Bank of Tonga

During the month of October 2019, both the Nominal Effective Exchange Rate (NEER) and Real Effective Exchange Rate (REER) index slightly declined. This was attributed to the appreciation of the USD, FJD, GBP, EUR and CNY against the TOP. The NEER and REER also fell over the year due to Tonga's lower inflation rate compared to most of its major trading partners, which may support Tonga's international trade competitiveness.

Net outflow in foreign exchange

Table 5: Foreign Reserves

	Monthly			Annual	
	Oct-19	Sep-19	% Growth	Oct-18	% Growth
Foreign Reserves (\$ in million)	489.3	490.8	-0.3	457.3	7.0
Import Coverage (months)	7.8	7.9		7.7	

Source: National Reserve Bank Tonga

The level of official foreign reserves lowered by \$1.5 million to \$489.3 million (equivalent to 7.8 months of imports cover) attributed to higher offshore investments and payments for services during October 2019. However, the foreign reserves rose over the year by \$32.0 million as a result of higher receipts of budget support, grants, and project funds from development partners. This was also supported by the increase in the remittance receipts from family and friends abroad.

Table 6: Overseas Exchange Transactions
Overseas Exchange Transactions

	Monthly			Annual		
	Oct-19	Sep-19	% Growth	Oct-19	Oct-18	% Growth
Overall Balance	-1.5	-0.9	-61.2	32.0	43.7	-26.8
Current Account	8.2	-12.7	164.7	13.0	-3.3	494.7
Merchandise Trade	-33.9	-35.4	4.2	-409.4	-407.9	-0.4
Services	-0.2	2.0	-111.0	27.9	17.2	61.9
Income	1.1	-2.0	154.1	5.5	4.7	17.2
Transfers	41.2	22.8	81.0	389.1	382.7	1.7
Capital Account	1.2	1.7	-26.1	36.0	34.4	4.7
Financial Account	-10.9	10.1	-208.2	-17.0	12.7	-233.9

Source: Banking Systems

The deficit in the overall Overseas Exchange Transactions (OET) balance widened during October 2019, mainly attributed to the \$11.2 million portfolio investment abroad. Services payments also increased by \$2.8 million which were mostly for telecommunication services. Nonetheless, receipts also increased over the month, mainly from transfer receipts, both official and private receipts. Official revenues were mainly budget support, grants & project funds, while private transfers are grants/donations to non-profit organizations and remittance receipts to individuals.

A similar trend is portrayed in the annual movements, where the OET balance surplus decreased and is underpinned by higher outflows for offshore investments and import payments. These movements have offset the rise in receipts from travel, private transfer receipts, and exports.

Broad money decreased further

Table 7: Broad Money

	Monthly			Annual	
	Oct-19	Sep-19	% Growth	Oct-18	% Growth
Broad money (\$ in million)	592.5	594.5	-0.3	595.8	-0.6
Net Foreign Asset	503.9	504.5	-0.1	474.6	6.2
Net Domestic Asset	91.3	90.7	0.8	121.6	-24.9

Source: Banking System, National Reserve Bank of Tonga

Broad money declined further by \$2.0 million (0.3%), again driven by a decrease in net foreign assets, which offsets the slight rise in net domestic assets. The lower net foreign assets were mostly driven by offshore investments during the month, whereas lower capital accounts increased net domestic assets. Over the year, broad money declined by \$3.3 million (0.6%) due to lower net domestic assets, mainly on higher government deposits, offsetting the growing net foreign assets.

Liquidity declined

Table 8: Reserve money

	Monthly			Annual	
	Oct-19	Sep-19	% Growth	Oct-18	% Growth
Reserve money (\$ in million)	309.4	317.4	-2.5	325.0	-4.8

Source: Banking System, National Reserve Bank of Tonga

Higher foreign exchange payments made by the commercial banks for their underlying customers over the month and year to October 2019, lowered the liquidity in the banking system to \$309.4 million, by \$8.0 million (2.5%) and \$15.7 million (4.8%) respectively.

Business loans increase in October

Table 9: Total Lending

Lending	Monthly			Annual	
	Oct-19	Sep-19	% Growth	Oct-18	% Growth
Total Lending (\$ in million)	496.9	493.9	0.6	466.3	6.6
Business lending	238.6	235.2	1.5	210.4	13.4
Household lending	258.3	258.5	-0.1	255.3	1.1
Other lending	0.0	0.3	-84.0	0.6	-93.4

Source: Banking System, National Reserve Bank of Tonga

The banks' total lending grew over the month and year to October 2019, by 0.6% (\$3.0 million) and 6.6% (\$30.6 million), respectively to \$496.9 million. This increase was mostly driven by an expansion in lending to businesses. Loans to the professional & other services, agriculture, and tourism sectors expanded and drove the monthly rise, whereas more loans offered to the state-owned enterprises, professional & other services, transport and tourism sectors resulted in the annual increase. Household loans, however, decreased over the month but increased over the year reflecting the movements in housing loans.

The banks' total loans to deposit ratio slightly increased from 78.6% to 79.1% over the month, reflecting the increase in loans and the fall in deposits.

Interest rate spread narrowed

Table 10: Weighted Average Interest Rates

Interest Rates	Oct-19	Monthly Sep-19	Growth (bps)	Oct-18	Annual Growth (bps)
Weighted Average Banks Deposit Rate (%)	1.933	1.944	-1.1	1.978	-4.5
Weighted Average Banks Lending Rate (%)	7.970	7.999	-2.8	8.121	-15.1
Weighted Average Interest Rate Spread (%)	6.038	6.055	-1.7	6.143	-10.5

Source: Banking System, National Reserve Bank of Tonga

Over the month and year to October 2019, the weighted average interest rate spread narrowed by 1.7 basis points and 10.5 basis points respectively to 6.04%, due to a decrease in both weighted average lending rates and weighted average deposit rates.

The lower lending rates over the month and year resulted from lower lending rates on non-profit institutions and household loans. Business lending rates slightly rose over the month; however, it decreased over the year and supported the annual decline in the weighted average lending rates.

The declining deposit rates over the month were solely driven by lower demand deposits rates, which outweighed the increase in both saving and time deposit rates. Over the year, the declined time deposit rates drove the lower weighted average deposit rates.

Outlook

The Reserve Bank expects positive domestic economic activity in the medium term. Foreign reserves will remain at comfortable levels above the minimum of 3 months of import cover. The inflation forecast is also expected to be relatively stable and below the Reserve Bank's reference rate of 5%. Credit growth will continue to grow albeit at a slower pace, underpinned by excess liquidity in the banking system. The Reserve Bank, therefore, maintains its accommodative monetary policy stance to encourage the utilization of the excess liquidity in the banking system for further lending hence supporting economic growth. Nonetheless, the Reserve Bank continues to be vigilant in closely monitoring developments in the domestic and global economies and stands ready to adjust its monetary policy setting to ensure financial and macroeconomic stability are maintained.