

Economic Overview

Overseas Economies

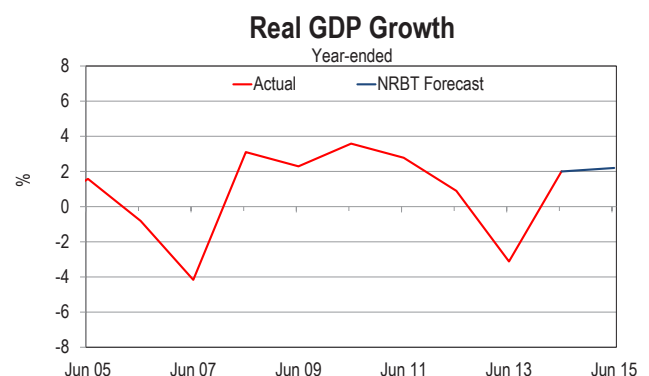
Developments in Tonga's key trading partners varied yet continued to support domestic economic activities. Unemployment in the US and New Zealand fell over the year from 6.1% to 5.3% and 6.0% to 5.8% respectively, while it remained unchanged at 6.0% in Australia. World oil prices declined over the year to June 2015 by more than 40% from US\$113 to US\$62 per barrel. The US dollar strengthened against the currencies of Tonga's major trading partners in the year to June 2015. This was translated to the Tongan pa'anga appreciating against the Australian and the New Zealand dollar while it depreciated against the US dollar. The stronger Tongan pa'anga may exert some pressure on Tonga's export industries and other receipts such as remittances and tourist receipts, while easing imported inflation.

Developments in the Domestic Economy

The National Reserve Bank of Tonga estimates Tonga's Real Gross Domestic Product (GDP) growth of 2.2% in 2014/15 based on strong growth from the construction sector, trade, transportation and communication sector, financial intermediation and the tourism industry.

Although the Agricultural sector contracted in 2014/15 due mainly to the adverse weather conditions, following a very productive year in 2013/14, all other sectors advanced which boosted domestic economic activity. This is supported by preparations for festivities and special events scheduled for mid-2015. The volume of agricul-

tural exports fell by 18.9% over the year due to decline in root and vegetable products. This coincides with a 34.1% decrease in agricultural proceeds. Despite enabling conditions set in place such as managed funds loans to assist in boosting agricultural sector growth, the adverse weather conditions throughout the year had a large impact on agricultural output. In contrast, the trade sector advanced, coinciding with a 15.3% rise in container registrations. Payments for imports excluding oil also showed an increase over the year. Likewise, International air arrivals increased by 8.0% indicating an active tourism sector. This in turn benefited the transportation sector, especially tour operators. Vehicle registrations rose by 28.9% due mainly to an increase in "Taxis & Rentals" and an influx of donor-funded vehicles for the coronation. These annual movements align with the NRBT's GDP estimate for 2014/15.



Source: Tonga Department of Statistics; NRBT



Monetary Policy Formulation

Monetary policy Actions

The NRBT's monetary policy target is to maintain adequate level of foreign reserves above 3-4 months of import cover and to promote low and stable inflation below 6% annually.

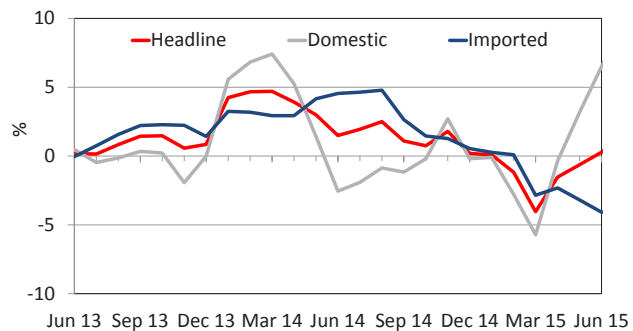
Against the background of low inflation, high foreign reserves, stable and competitive exchange rates, improving monetary conditions with high liquidity, improving credit and deposit growth and narrowing interest rate spreads, the Reserve Bank maintained its accommodative monetary policy stance to continue to support macroeconomic stability and economic growth.

The Statutory Required Deposits was left unchanged at 5% and there were no Open Market Operations. Similarly the Exchange Control requirements in terms of delegated limits to the banks and authorised foreign exchange dealers remained unchanged during the year. The annual review of the exchange rate basket was conducted to update the basket with the current overseas exchange transaction patterns. The Liquid Asset Requirement also remained unchanged at 5% during the year.

Monetary Policy Outcomes

Headline inflation remained relatively low over 2014/15. Consumer Price Index (CPI) records 0.2% inflation over the year to June 2015 after four consecutive months of headline deflation. This was caused by Domestic prices which increased by 6.6%, offsetting a 4.1% decline in Imported prices. Prices for food items, namely Fruit & Vegetables and Meats, Fish & Poultry caused a 21.5% increase in Domestic Food prices whereas the same food items drove Imported Food prices down by 4.3%. Contrastingly, Domestic Fuel & Power prices fell over the year affecting the Household Operation and Transportation components. However, this was insufficient to offset the rise in Food prices.

Inflation



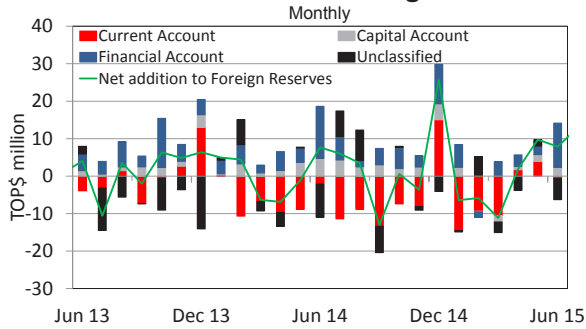
Source: Tonga Department of Statistics; NRBT

Import payments grew by 15% to \$301.1 million over the year to June 2015. Driving the rise were mainly payments for imports of wholesale & retail goods, construction materials, and motor vehicles. Export receipts were slightly lower than a year ago, with proceeds from fish and other marine exports more than enough to offset a fall in agricultural exports. Remittances remained at high levels of \$202.4 million, a decrease from \$208.9 million in the previous year. This is primarily due to a change in methodology for calculating remittances following Tonga's transition in May 2014 into Balance of Payments and International Investment Position Manual 6 (BPM6), endorsed by the International Monetary Fund (IMF). Official transfers for budget support and other aid funds from donor partners rose by over \$15 million over the year to June 2015. A portion of this funding consisted of budget support delayed from the previous financial year.

Over the year to June 2015, the net Overseas Exchange Transactions (OET) therefore recorded a net inflow of \$15.2 million, 36% higher than the net inflow recorded a year ago. The foreign reserves rose by \$15.2 million to \$289.7 million in the year to June 2015, sufficient to cover 7.9 months of imports, and well above the NRBT's minimum range.



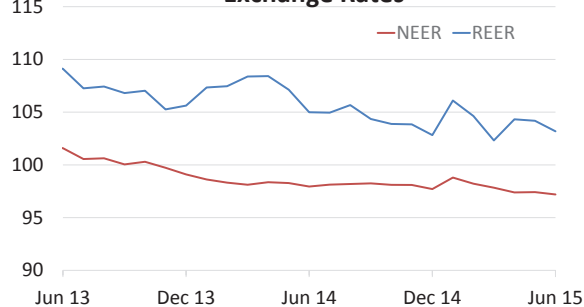
Balance of Overseas Exchange Transactions



Source: NRBT; Banking System; Foreign Exchange Dealers

The Nominal Effective Exchange Rate (NEER) fell in 2014/15 by 0.8% following an appreciation of the US dollar which was partially offset by the depreciation of the Australian and New Zealand dollar against the Tongan Pa'anga. The Real Effective Exchange Rate (REER) continued to decline in 2014/15 by around 1.7%. The lower REER indicates an improvement in Tonga's price competitiveness against that of its major trading partners.

Nominal and Real Effective Exchange Rates

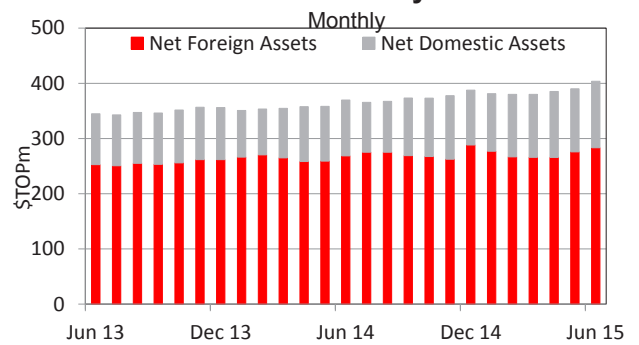


Source: NRBT

Over the year to June 2015, Broad Money rose by 9.3%, due to a 19.7% rise in net domestic assets and a 5.5% rise in net foreign assets. The increase in net domestic assets reflects a 10.6% increase in banks' lending while an increase in the foreign reserves drove the growth in net foreign assets. Total domestic demand deposits and currency in circulation also increased in line with the rise in broad money. Banking system liquidity also increased over the year by 13.7%.

In year ended terms, total bank lending balances rose by 11.4% (\$31.5 million) supported by the high liquidity in the banking system and the decline in lending interest rates. Including loans extended by non-banks, the lending balance increased by 8.2% over the year. Weighted average interest rate spread narrowed to a record low of 5.95% from 6.54% in June 2014.

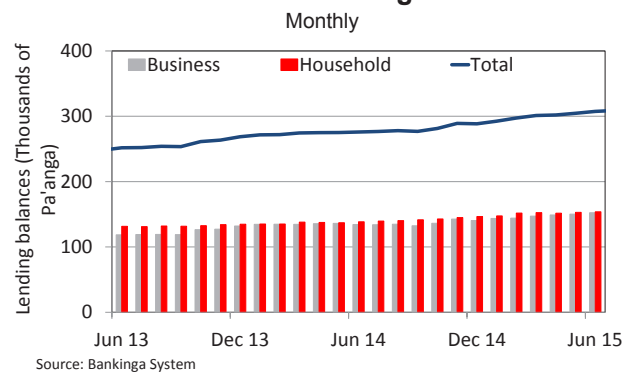
Broad Money



Sources: NRBT, Banking System

Net credit to government increased by 8% over the year to June 2015 compared to a decline of 20% over the year to June 2014. The rise in net credit to government reflects more than 15% rise in banks' holdings of government bonds and a 2% fall in government deposits.

Banks' Lending



Source: Banking System