

Monthly Economic Review

For October 2015

Tonga continues to benefit from global developments. Economic activity in the US has been expanding at a moderate pace with unemployment rate declining over the month to 5.0% as household spending and business investment increased. Unemployment in Australia remains at 6.1%. However, latest data reported New Zealand's unemployment rate to have risen to 6.0% in the September 2015 quarter. World oil prices changed little over the month remaining around US\$48 per barrel. The Tongan Pa'anga depreciated against the New Zealand Dollar and appreciated against the Australian Dollar, and the U.S. Dollar.

Domestic economic activities continue to support the National Reserve Bank of Tonga's forecast for domestic growth. Over the month of October 2015, economic activities picked up particularly in the primary production. Further growth is anticipated in the primary sector from the possible opening up of the market in China for squash exports. Agricultural exports volumes more than tripled from September due largely to squash with October being the start of its harvesting season. Container registrations were slightly lower than in September by 6.5%, yet this is anticipated to pick up with Christmas fast approaching. Vehicle registrations rose by 20.8%. Total arrivals in the Kingdom rose by 6.6% compared to the previous month, driven by a 77% rise in cruise ship arrivals more than offsetting a 10.8% fall in air arrivals over the month.

Headline inflation rose over the month of October by 0.4%. The prices of domestic components rose by 1.1% with the most significant rise recorded for fruits and vegetables such as pineapples, taro, and late yams. Imported inflation fell by 0.2% due to a fall in imported transportation. The latest fuel prices have fallen for the November/December period in line with the lower global oil prices. Electricity prices has fallen by 2.69 seniti per kilo watt hour effective on 1st December 2015 as a result of lower fuel prices.

Over the year ended October 2015, headline inflation declined by 1.3%, well below the NRBT's reference range of 6-8%. This was due to the prices of items with the greatest weight in the imported component, mainly food and transportation, falling faster than rises in prices of items in the domestic component such as domestic food. The core measures of inflation were also below the reference range.

The Nominal Effective Exchange Rate (NEER) and the Real Effective Exchange Rate (REER) both declined over the month of October 2015 by 0.8% and 0.7% respectively due mainly to the depreciation of the Tongan Pa'anga against the New Zealand Dollar (NZD) coupled with Tonga's continued annual deflation. This continues to benefit Tonga's price competitiveness against that of its major trading partners.

Total Overseas Exchange Transactions (OET) Payments fell by 17.2% over the month of October to \$47.6 million. This was due to a 17.7% fall in current account payments driven by decreases in import, services and primary income payments. Import payments fell by 5.6% due mainly to lower oil import payments. Service payments fell by 27.8% coinciding with lower payments of transport, travel, professional and business services. Primary income payments also fell by 90.8% as there were minimal interest payment on external loans recorded for the month.

Total OET Receipts however rose by 5.5% over the month to \$57.6 million. This was driven by increases in the capital and financial accounts despite a 13.5% fall in the current account. Receipt of private grants for capital projects over the month contributed to the higher capital account receipts, whilst a 79.3% rise in financial account was the result of higher interbank transfers with overseas correspondent banks. The lower current account receipts for the month reflects the fall in official transfers compared to last month's receipt

of budget support of \$8 million. Total remittances, on the other hand, rose by 13.4% over the month however not enough to offset the fall in official transfers. Proceeds from squash exports helped in improving the receipts from agricultural products, however this was offset by a fall in proceeds from fisheries and marine exports, resulting in no significant changes to total export receipts over the month.

The balance of OET over the month of October, which is the net change to gross foreign reserves, recorded a surplus of \$4.1 million, which is \$3.2 million higher than that in the previous month. The higher surplus reflects a combination of higher net surpluses in the capital and financial accounts recorded for this month which was \$2.3 million and \$13.1 million, and a lower net deficit in the current account of \$5.4 million. Gross foreign reserves reached a new record high of \$315.8 million at the end of October, which is equivalent to 9.1 months of import cover, well above the NRBT's minimum range of 3-4 months.

Broad money increased over the month by 1.5% to \$428.7 million, due to a 2.6% rise in net domestic assets and a 1.1% increase in net foreign assets. The rise in net domestic assets reflects the increase in lending while an increase in foreign reserves drove the increase in net foreign assets. Broad money also increased over the year by 14.9%, underpinned by the increases in net domestic assets and net foreign assets. Total domestic demand deposits and currency in circulation also increased in line with the rise in broad money. Banking system liquidity rose over the month and over the year by 2.0% and 14.3% respectively underpinned by the increases in deposits and foreign reserves.

Bank lending increased over the month by 1.4% to \$320.1 million, due to increases in all the categories with household loans being the main driver. Including loans extended by non-banks, total lending also increased by 1.4% reflecting the end of government on-lent loans. At the same time, 70 new loans were approved from the managed funds scheme compared to 64 loans in the previous month, totalling to about \$0.5 million. Majority of these new loans were for new and existing customers in the agricultural sectors supporting growth in agricultural activities. In

year ended terms, total bank lending increased by 13.8%, underpinned by the increases in lending to businesses and households. Including loans extended by non-banks, total lending increased by 13.6%, with household loans being the main driver.

Weighted average interest rate spread narrowed over the month from 5.98% to 5.80% in October 2015. This was driven by a decline in weighted average lending rate and weighted average deposit rate to 8.14% and 2.29% respectively.

Net credit to government slightly rose over the month by 1.1% due to a 0.8% fall in government deposits. The lower government deposits reflect government commitments to ongoing donor funded projects and payment for services. Drawdown of managed funds loans over the month also contributed to the fall in government deposits. Both government receipts and payments based on OET data fell over the month, particularly after receiving budget support funds from donor partners last month.

Given the above developments, the NRBT's outlook for a broadly positive domestic growth remains. Economic activities, particularly in the primary production, picked up over the month of October 2015. Annual headline inflation is expected to remain within the reference range in the near term largely in anticipation of continued lower world oil prices. We also expect robust credit growth as business confidence and conditions improve. The banking system continued to remain relatively stable and profitable, with reported credit growth and strong liquidity and capital positions. Minimal liquidity pressures together with ample foreign reserves supports no change to the monetary policy settings in the near-term.

The NRBT will continue to promote prudent lending, closely monitor credit growth and be mindful of the impact of a continued deflation. The NRBT will closely monitor the country's economic developments and financial conditions to maintain internal and external monetary stability, promote financial stability and a sound and efficient financial system to support macroeconomic stability and economic growth.

