



Global developments over October were relatively stable as indicated by mixed performances of major trading partners. The U.S. economy experienced the fastest pace of growth in two years. Real GDP growth of 2.9% was recorded for the year ended September 2016 for the U.S., due to increases in exports, inventory investments, and federal government spending. In addition the unemployment rate fell to 4.9%. The Reserve Bank of Australia reportedly held the cash rate steady at 1.5% and expect this to be the case for some time given low inflation and subdued growth in labour costs. New Zealand's latest data show that consumer prices rose by 0.2% over the September quarter exceeding expectations as higher housing-related prices were countered by lower transportation prices. NZ unemployment also improved to 4.9% over the September 2016 quarter from 5% in the previous quarter.

Domestic economic activities remained positive in October 2016 with mixed indicators. The total agricultural export volumes rose by 2,513.4 tonnes over the month. This is the highest total monthly exports on record since October 2013 (*Figure 1*) reflecting the commencement of the squash season. The secondary sector remained strong, supported by rises in individual housing loans and business loans for the construction and manufacturing sectors. Vehicle registrations rose in October by 65 vehicles (23.1%), whilst container registrations slightly fell by 4 containers (0.5%). Activities in the financial sector were supported by higher credit growth during the month. Air arrivals declined in October however the arrival of the Costa Luminosa, the largest cruise ship to arrive in Tonga supported the tourism sector. Whale watching activities also continued to benefit this sector.

The total number of job advertisements over October continued to fall by 15 vacancies however rose over the year by 62 vacancies led by recruitment intentions in all the sectors except for the industry sector. This indicates a rising demand for labour in Tonga and may assist in reducing the unemployment rate.

The headline inflation rate for October is yet to be released by the Statistics Department. The NRBT expects the annual headline inflation rate to be around 6.7% in October 2016, a slight decrease from 7.1% in the previous month.

In October, the United States Dollar (USD) and the Australian Dollar (AUD) appreciated against the Tongan Pa'anga (TOP) while the New Zealand Dollar (NZD) depreciated against the TOP (*Figure 2*). The Nominal Effective Exchange Rate (NEER) slightly rose over the month by 0.4%, but fell over the year by 4.0%. The Real Effective Exchange Rate (REER<sup>1</sup>) also rose over the month by 0.3% and over the year by 1.0%, which may impact Tonga's international competitiveness.

Overseas Exchange Transactions (OET) payments fell to around \$52 million in October from a very high level of \$61 million in September. Payments for imports of goods and services substantially fell by \$9.4 million in all major categories driving the lower OET payments.

OET receipts however, still remained high at \$61 million in October, despite falling by \$1.4 million (2.2%) over the month, largely owing to the inflow of government budget support funds during the month. Agricultural export proceeds also recorded a \$0.8 million (86%) increase over the month mostly from squash exports, partially offsetting a \$0.5 million (50.7%) fall in proceeds from fish and other marine exports. Travel receipts also declined in October by \$1.9 million (19%) to \$8.1 million due to lower receipts from personal travel services.

The overall balance for October 2016 which is the net change to foreign reserves was a surplus of \$3.3 million (*Figure 3*). This brings the official foreign reserves to \$367.0 million (*Figure 4*) by the end of October, equivalent to 9.3 months of imports cover, which is well above the NRBT's minimum range of 3-4 months<sup>2</sup>.

<sup>1</sup> REER based on the NRBT's forecasted inflation rate.

<sup>2</sup> IMF projects the level of foreign reserves for 2016/17 to be equivalent to 5.7 months of goods and services imports.



## MONTHLY ECONOMIC REVIEW

Vol. 3

No. 10

Month Ended: October 2016

Broad money rose over October 2016 by \$5.0 million (1.0%) setting a new high record of \$501.2 million (*Figure 5*). This was a result of an increase in both the net foreign assets (NFA) and net domestic assets (NDA) of \$2.2 million (0.6%) and \$3.0 million (2.4%) respectively. The increase in foreign reserves drove the rise in NFA whilst the increase in private sector domestic credit drove the rise in NDA. Liquidity (reserve money)<sup>3</sup> decreased over the month by \$0.5 million (0.2%) to \$267.6 million which resulted from lower banks' deposits to the NRBT vault. Broad money rose by \$72.5 million (16.9%) over the year due mainly to a marked increase in NFA of \$71.7 million (23.7%).

Total bank lending rose by \$5.5 million (1.5%) to \$368.2 million in October 2016 (*Figure 6*). Increases in all household lending categories contributed to a \$4.1 million (2.1%) growth in household loans over the month to a new high record of \$203.8 million, specifically the increase in housing loans. Business lending grew over October 2016 by \$1.4 million (0.9%). This was driven by growth in loans to the agricultural, construction and manufacturing sectors. The increasing activity in the agricultural sector was partially supported by low interest rates from the Government Development Loans scheme. Annual credit growth as at the end of October 2016 was \$47.9 million (15.0%), which is higher than in the same period last year and is expected to grow stronger towards the final months of the year.

Higher interest rates on business and other personal loans contributed to an increase in the weighted average lending rate of 1.3 basis points to 7.89%. However, the weighted average deposit rate fell by 4.5 basis points to 2.25% due mainly to lower term and savings deposits rates.

Consequently, the weighted average interest rate spread widened by 5.8 basis points to 5.64% in October 2016. Over the year, the weighted average interest rate spread narrowed by 15.9 basis points due mainly to declines in both the weighted average lending rate and weighted average deposit rate. Total loans to deposit ratio rose slightly to 74.1% in October 2016 from 73.8% last month. This remains below the 80% minimum requirement for the banks' loan to deposit ratio and indicates excess liquidity existing in the banking system.

Net credit to government fell over the month and over the year by \$5.1 million and \$22.8 million respectively driven by a rise in government deposits. This was due to the receipt of budgetary support funds during the month and government bonds issued over the year.

The NRBT's expectation for strong domestic economic activity remains in the near term. The level of foreign reserves is also expected to remain comfortable supported by expected higher receipts of remittances and foreign aid, despite the projected rise in imports. Upward inflationary pressure is expected in the near term due to amendments made to custom duty and excise tax effective on 1<sup>st</sup> July 2016. The banking system remains sound. NRBT will continue to closely monitor and review its monetary policy setting to maintain internal and external monetary stability, and to promote a sound and efficient financial system to support macroeconomic stability and economic growth.

<sup>3</sup> Liquidity in the banking system (reserve money) is a sum of currency in circulation, exchange settlement account balances, and required reserve deposits.



# NATIONAL RESERVE BANK OF TONGA

## MONTHLY ECONOMIC REVIEW

Vol. 3

No. 10

Month Ended: October 2016

Figure 1:

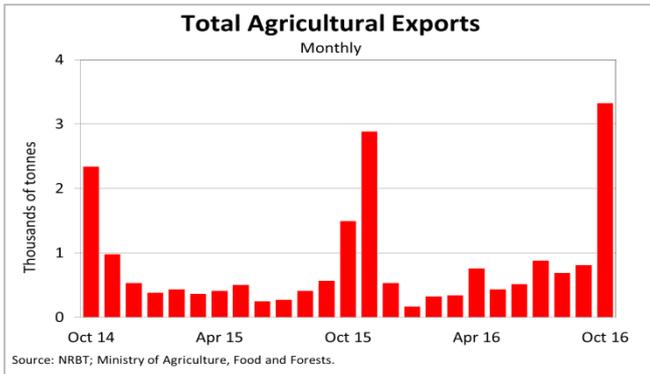


Figure 4:

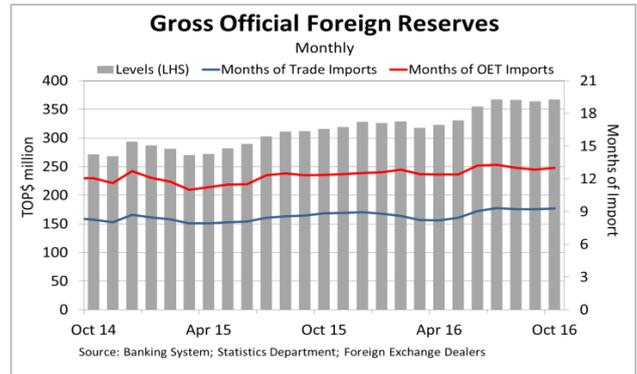


Figure 2:

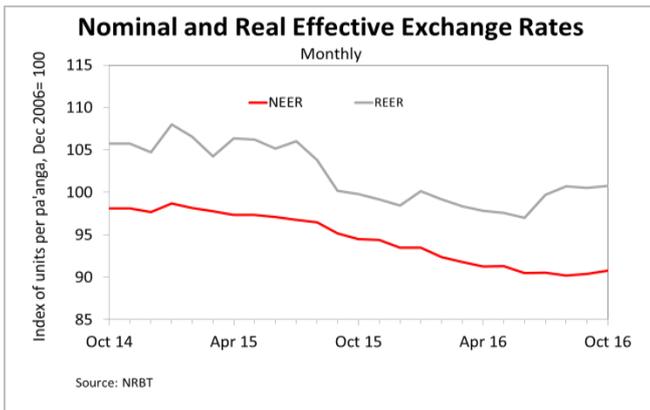


Figure 5:

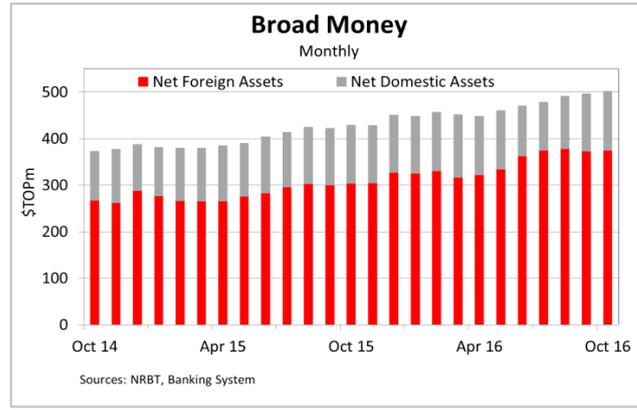


Figure 3:

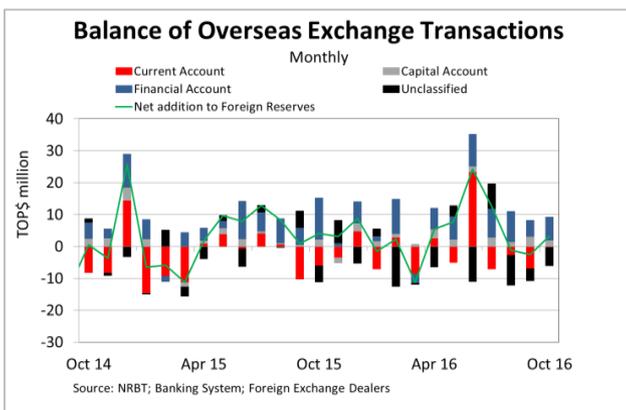


Figure 6:

