



MONTHLY ECONOMIC REVIEW

Vol. 3

No. 8

Month Ended: August 2016

Global growth continued to remain relatively stable. The U.S. according to the Consensus Forecasts experienced soft GDP growth of 1.2% in the June quarter due to weak growth indicators within the manufacturing and service sectors. Whereas for the Euro Zone's GDP growth halved over the June quarter compared to 0.6% growth in March quarter. This was due to flat investment and lower household spending. Australia reportedly had stronger growth of 3.3% in the June quarter compared to a 3.0% growth in the March quarter as a result of a substantial rise in resource exports. New Zealand recorded a 3.5% growth in the June quarter relative to a 2.8% growth in March quarter. This was supported by strong inward migration, construction activity, tourism, and accommodative monetary policy. However, low dairy prices are depressing incomes in the dairy sector and reducing farm spending and investment.

Domestic activity was mixed over August. The volume of agricultural exports was 707.3 tonnes, 19.7% less than the previous month (*Figure 1*) reflecting a seasonal fall of yams exports in August. On the other hand, recent figures show that the export of butternut has begun. Butternut and squash pumpkin are the main drivers behind agricultural exports peaking in the last quarter every year. Marine exports declined slightly by 6% from July (*Figure 2*) but remains at high levels, the third highest this year of 255.4 metric tons. Container registrations rose over the month by 8.5% driven by business shipments. With food such as meat being a main source of import for Tonga, the next few months will show how much of an impact the excise tax will have on container registrations for businesses. Construction of St. George's Palace, Tano'a Hotel and the Fua wharf are ongoing.

Data on job vacancies collected by the NRBT in August registered a monthly growth of 38.7%. Vacancies in the hotel & restaurant sector have made a notable comeback owing to recruitment by the Tano'a Hotel. The NRBT expects the economy to grow firmly in the near future with increased demand for labour supporting a lower unemploy-

Figure 1:

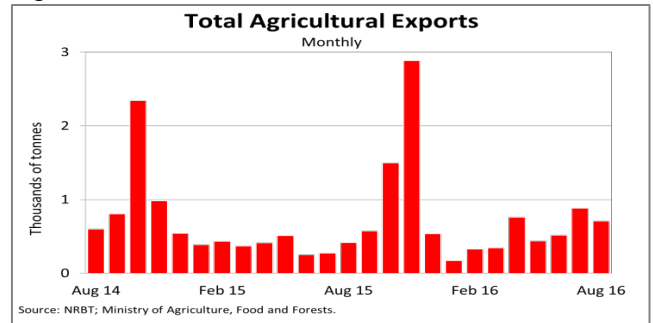


Figure 2:

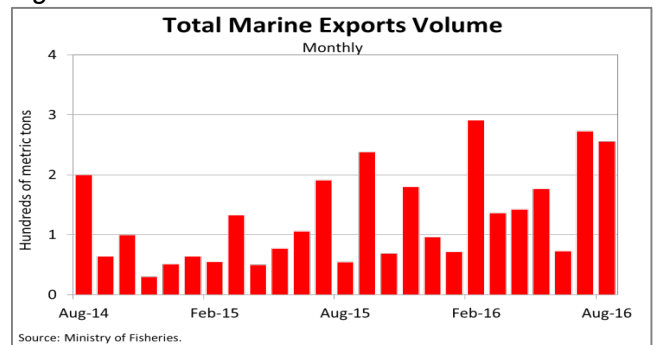
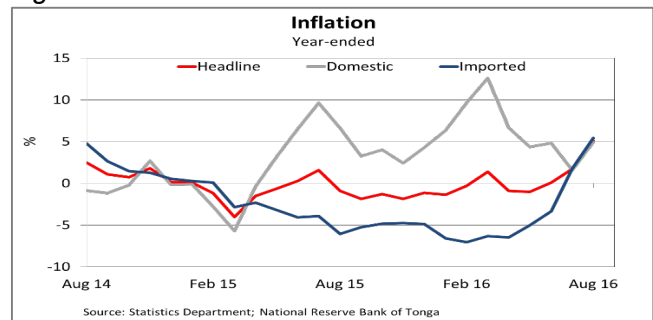


Figure 3:



ment rate.

Monthly headline inflation for August rose by 1.6%. The rises in prices were mainly driven by the prices of imported food component. The high prices stem from the new customs duty and excise tax introduced in July on certain cuts of meat, including lamb flaps and chicken pieces to name a few.

Annual headline inflation significantly increased by 5.1% in August 2016 compared to 1.6% in July 2016. This reflects the effect of the new excise tax, resulting in overall prices being much higher than the same period last year (*Figure 3*).

In August 2016, majority of the major currencies depreciated against the Tongan Pa'anga (TOP)



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including the United States dollar (USD), Australian Dollar (AUD), Chinese Yuan (CNY), British Pound (GBP) and Euro Dollars (EURO). On the other hand, the New Zealand (NZD), Fijian Dollar (FJD) and Japanese Yen (JPY) appreciated against the TOP. These triggered a 0.3% fall in Tonga's Nominal Effective Exchange Rate (NEER), whilst the Real Effective Exchange Rate (REER) rose by 1.0% (Figure 4). Over the year, both the NEER and the REER fell by 6.5% and 3.0% respectively, giving both Tongan exporters and recipients of foreign currency a more competitive edge than their major trading partners.

Total payments in the Overseas Exchange Transactions (OET) were at \$52.8 million in August, \$0.5 million (1.0%) higher than the previous month. This was mostly due to a \$1.4 million (29.3%) increase in personal transfers to family and relatives abroad. This was partially offset by declining payments for services and import of oil.

Total OET receipts also rose by \$4.0 million (7.0%) to \$61.0 million over the month. This was driven by higher receipts of remittances, personal travel, and funds for non-profit organizations which were mostly for church operations. The LDS Tonga Mission centennial celebration in August may have contributed to the monthly trend.

The overall balance for the month of August, which is the net change to foreign reserves, recorded a deficit of \$1.2 million, after it has been on a surplus since April this year. This brings official foreign reserves to \$366.3 million (Figure 6), equivalent to 10.4 months of import cover, which is above the NRBT's minimum range of 3-4 months¹.

Broad money rose by \$13.0 million (2.7%) in August reaching a record high of \$491.0 million (Figure 7). Both the net domestic assets and net foreign assets increased by \$9.6 million (9.2%) and \$3.6 million (1.0%) respectively. A rise in bank's lending and the persistent high level of foreign reserves contributed to the growth.

¹ IMF projects the level of foreign reserves for 2016/17 to be equivalent to 5.7 months of goods and services imports.

Figure 4:

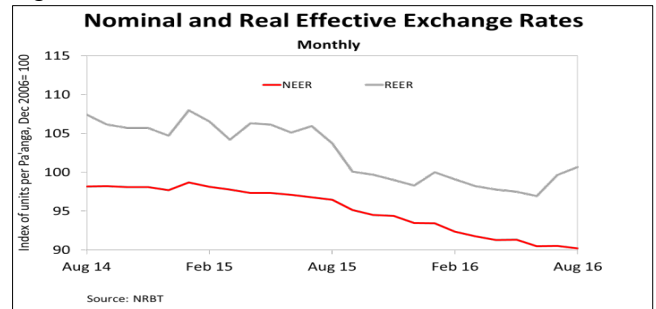


Figure 5:

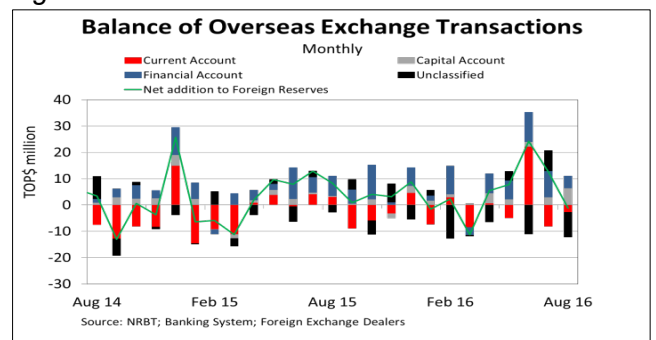


Figure 6:

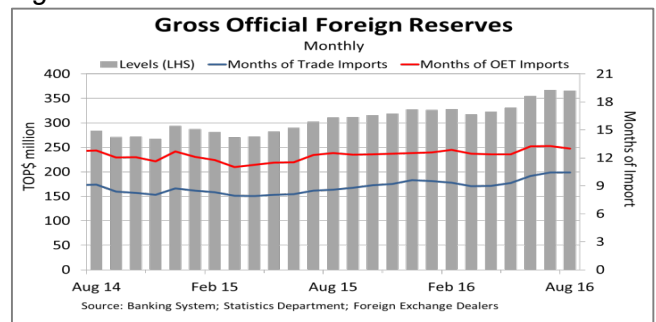
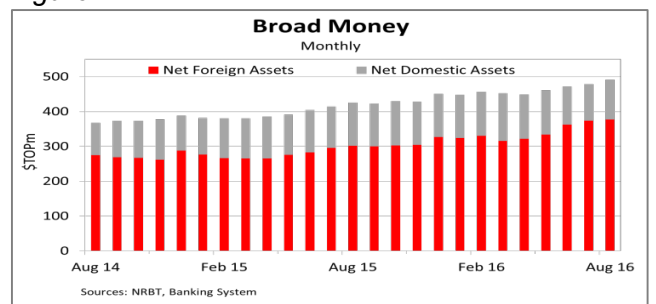


Figure 7:



The liquidity (reserve money) in the banking system also increased by \$1.7 million (0.6%) in August to \$267.2 million, due mainly to an increase in the banks' deposits to the NRBT vault. In the year to August, broad money grew significantly by



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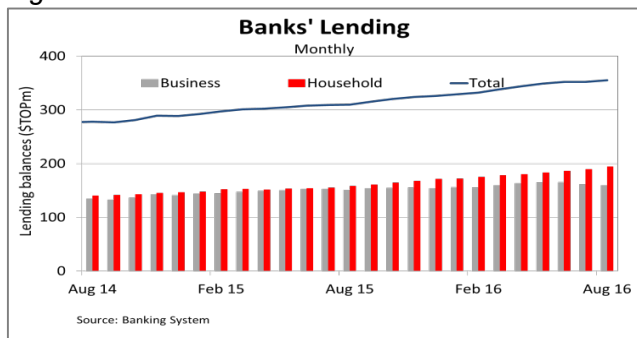
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\$66.9 million (15.8%) as a result of a marked increase in net foreign assets by \$75.5 million (25.0%) outweighing a \$9.0 million (7.3%) fall in net domestic assets.

A pick-up in bank's lending by 1.0% (\$3.3 million) has taken lending to a new high record of \$355.2 million in August (Figure 8). A \$4.8 million (2.5%) increase in household lending set off a \$1.6 million (0.7%) decline in business lending. Housing loans continues to rise and had recorded the highest monthly growth of 3.7% (\$4.95 million) since February 2015. This outweighed a \$0.13 million (0.2%) fall in personal loans. By end of August 2016, annual credit had grown by 14.6%, much higher than 11.5% in the same period last year and is expected to grow stronger towards the final months of the year.

Figure 8:



Weighted average deposits rates changed a little in August while weighted average lending rates fell by 2.13 basis points due to lower interest rates on housing and business loans. The weighted average interest rate spread therefore slightly narrowed to

5.68% from 5.71% last month. Over the year, weighted average interest rate spread narrowed by 30 basis points, due mainly to a fall in the weighted average lending rates outweighing a decline in weighted average deposit rates. Meanwhile excess liquidity in the banking system remained evident from total loans to deposit ratio decreasing from 76.1% last month to 73.7% in August, which is below the 80% minimum loan to deposit ratio target that was effective on 1st July 2016.

Net credit to government rose by 2.3% due to a fall in government deposits by around \$2.0 million. Over the year, net credit to government however, fell by 40.7% due to a \$26.5 million (39.9%) increase in government deposits. This was due to the receipt of budgetary support and the government bonds issued.

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 higher expected 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 1st 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.