



MONTHLY ECONOMIC REVIEW

Vol. 3

No. 7

Month Ended: July 2016

The global economy continued to undergo softened growth. This has contributed to the downgrade in the latest Consensus Forecasts GDP growth forecasts for the US (from 1.9% to 1.5%) and Euro Zone (from 1.7% to 1.6%) due to lower productivity growth and drop in investments post-Brexit, respectively. Additionally, growth forecast for Australia was downgraded from 3.1% to 2.8%, projecting declines in exports and construction activities. In contrast, the growth forecast for New Zealand was upgraded (2.8% to 2.9%), supported by a rise in trade and construction data. China showed unchanged growth as they face considerable downward pressure particularly for property investments.

Domestic economic activities were generally positive in July 2016. The primary and secondary productions recorded strong growth over the month. Agricultural export volumes performed exceptionally well in July with volumes increasing by 365.5 tonnes (71.1%), (Figure 1), largely driven by a significant increase in the volume of cassava exports. In addition, marine exports also rose by 199.7 metric tons (274.4%), (Figure 2), owing largely to higher tuna exports. Furthermore, higher credit disbursements to individual housing and business loans for construction and manufacturing supported the secondary activities well. The financial sector remained strong during the month and continued to record higher credit growth. The tourism and trade sectors on the other hand declined over the month. International arrivals decreased by 3,073 passengers (25.8%), also containers registered fell by 201 registrations (21.6%). This follows a strong growth in June 2016 due to celebrations taking place during the month.

The total number of job advertisements for July declined by 10 vacancies which were mostly government vacancies. This indicates that some of the vacancies advertised last month may have been filled. However, the NRBT expects the economy to grow firmly in the near future with increased demand for labour supporting a lower unemployment rate.

Headline inflation rose by 2.8% over the month of July, compared with a much lower 0.1% rise in

Figure 1:

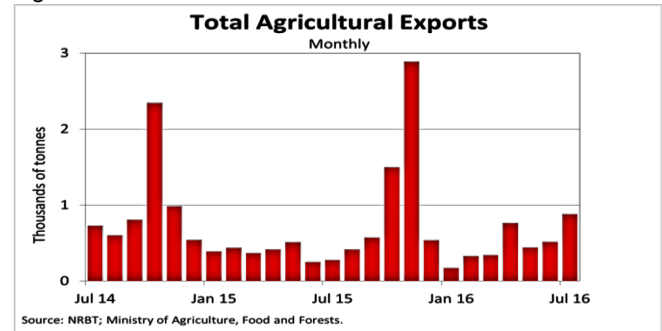


Figure 2:

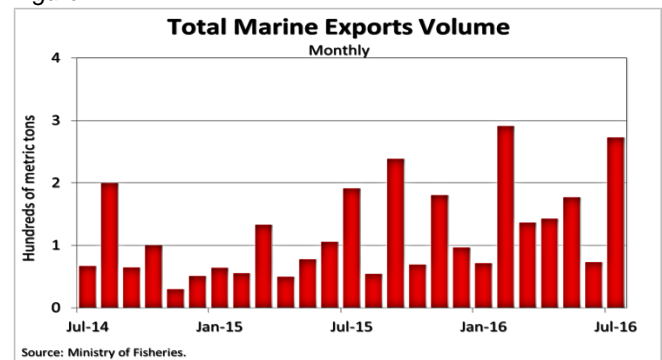
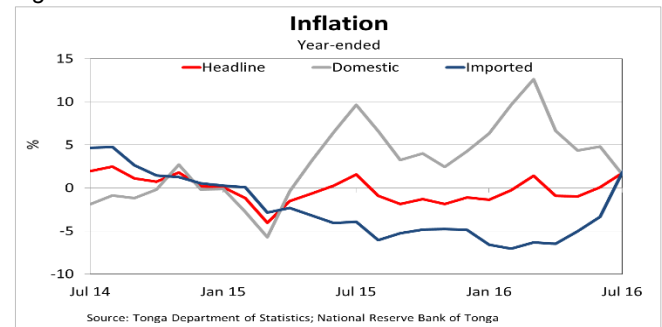


Figure 3:



June. The significant rise in prices was due mainly to the introduction of a new excise tax (Table 1) on imported fatty meat and tobacco. Higher prices of imported transportation (fuel) contributed as well to the monthly rise.

Annual headline inflation was at its highest for this year at 1.6%, surpassing a peak of 1.4% back in March 2016. (Figure 3).

In year ended terms, the prices of imported goods rose by 1.7%. This was due to higher prices of food and tobacco, alcohol and kava. Domestic inflation rose by 1.6% as shortage of kava continued and



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prices of other miscellaneous goods and services also rose over the year.

Table 1:

Customs Duty	Old rate	New rate
lamb breast & flap	-	15%
Mayonnaise	-	15%
Baby Diaper	-	15%
Article of Asbestos	-	15%
Excise Tax	Old rate	New rate
Chicken leg	-	\$0.40/kg
Turkey tail	-	\$1.50/kg
Mayonnaise	-	\$2/kg
Ice cream and other edible ice whether or not containing cocoa	-	\$1.50/kg
Lard	\$1/kg	\$2/kg
Sweetened drinks	\$0.50/L	\$1/L
Locally manufactured cigarettes	\$238 per 1,000 sticks	\$280 per 1,000 sticks
Imported tobacco	\$250 per 1,000 sticks	\$380 per 1,000 sticks
Other tobacco	\$250/kg	\$380/kg
Unleaded, aviation gasoline, kerosene, distillate fuel, residual fuel oil	\$0.50/L	\$0.65/L

Source: Ministry of Revenue & Customs

Over the month of July, the New Zealand Dollar (NZD), Japanese Yen (JPY) and British Pound (GBP) depreciated against the Tongan Pa'anga (TOP) while the Australian Dollar (AUD) and the United States Dollar (USD) appreciated against the TOP. Tonga's Nominal Effective Exchange Rate (NEER) and Real Effective Exchange Rate (REER) therefore both appreciated over the month by 0.1% and 2.8% respectively (Figure 4). In comparison to July 2015, both the NEER and the REER declined by 6.5% and 6.0% respectively benefitting Tongan exporters and recipients of foreign currency.

Total payments in the Overseas Exchange Transactions (OET) rose by \$2.6 million (5.3%) to \$52.3 million in July. This was driven mostly by a \$2.8 million (9.9%) increase in import payments over the month, particularly payments for imports of oil, construction materials and motor vehicles, which more than offset a decline in import payments for wholesale and retail goods.

Total OET receipts, on the other hand, fell by \$27.9 million (32.9%) to \$57.0 million in July due mainly to lower official receipts following a peak last month at \$84.9 million from inflows of government grants and

Figure 4:

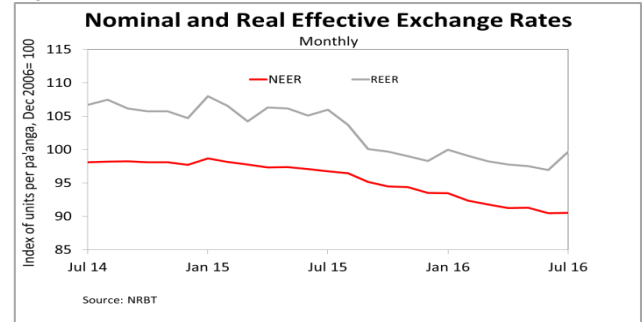


Figure 5:

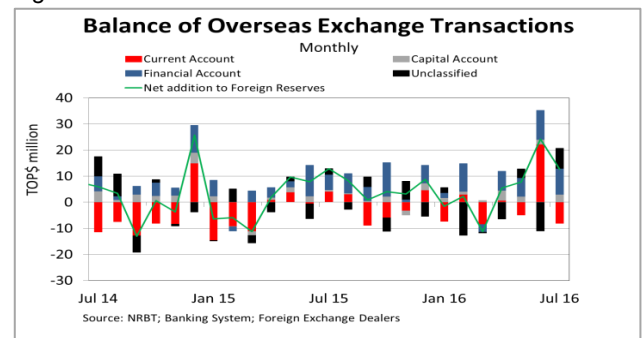
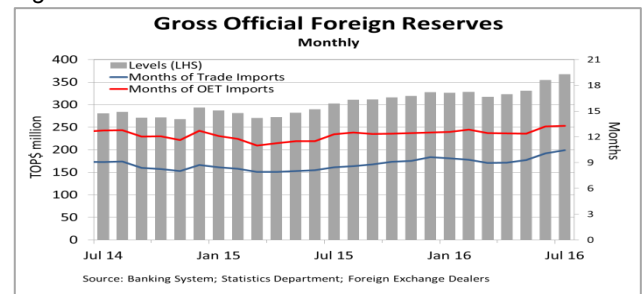


Figure 6:



budget support. Private transfer receipts, which are mostly remittances, also fell by \$2.1 million (9.5%) to \$19.9 million over the month.

The balance of OET for the month of July, which is the net change to foreign reserves, was a surplus of \$12.6 million, which was lower by \$11.6 million than the surplus in June (Figure 5). This lower surplus is largely due to the large government grants received last month. Official foreign reserves rose by \$12.5 million to \$367.4 million in July (Figure 6), equivalent to 10.4 months of import cover, which is well above the NRBT's minimum range of 3-4 months.¹

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



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Broad money grew over the month by \$7.5 million (1.6%) to another record high of \$478.0 million (Figure 7). This was due to a growth in net foreign assets by \$17.1 million (4.7%), offsetting a \$9.8 million (9.0%) decline in net domestic assets. The increase in foreign reserves contributed to the higher foreign assets whilst a decrease in other items (net) drove the lower domestic assets. The liquidity (reserve money) in the banking system rose by \$8.9 million (3.5%) in July to \$265.5 million, due mainly to an increase in banks' deposits to the NRBT vault. A significant rise over the year in net foreign assets of \$84.0 (28.4%) outweighed a \$19.6 million (16.6%) fall in net domestic assets resulting in an increase in broad money by \$64.5 million (15.6%) in annual terms.

Total bank lending slightly decreased over the month by \$0.4 million (0.1%) to \$351.9 million, following 18 consecutive months of growth. (Figure 8). The decline in business loans by \$3.5 million (2.2%) outweighed an increase in household loans by \$3.1 million (1.7%). The full settlement of a major loan to the public enterprises largely contributed to the monthly decline. The annual credit growth recorded an increase of \$42.8 million (13.8%), exceeding the NRBT and IMF's forecasts of 11.0% and 10.8% respectively for 2016/17.

An increase in business lending rates over the month drove the 4.5 basis points rise in weighted average lending rate. In contrast, weighted average deposit rate fell by 5 basis points due to lower interest rates for demand and term deposits. As a result, the weighted average interest rate spread slightly widened to 5.71% in July 2016 from 5.61% in the previous month. In year ended terms, weighted average interest rate spread narrowed by 23.7 basis points, due mainly to a fall in the weighted average lending rates outweighing a decline in weighted average deposit rates. Total loans to deposit ratio decreased to 73.0% from 75.2% in June, which is below the 80% minimum loan to deposit ratio that was effective on 1st July 2016. This indicates that excess liquidity in the banking system still remains.

Net credit to government rose over the month by \$6.7 million, due to a fall in government deposits

Figure 7:

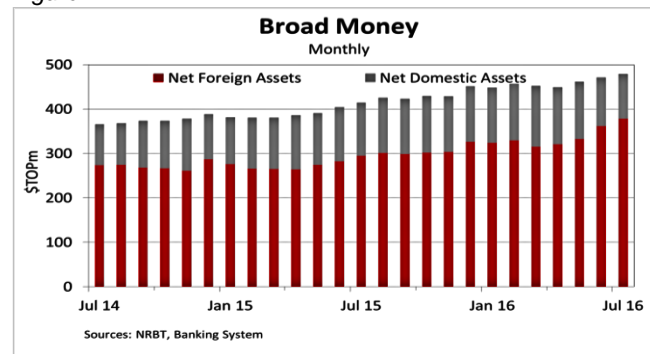
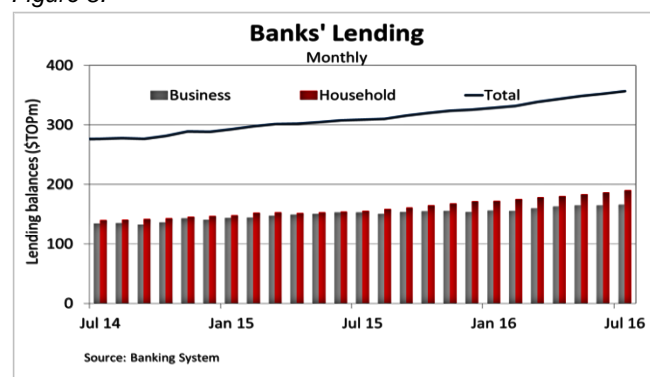


Figure 8:



particularly after receiving grants and budget support funds last month. The 2016/17 government budget estimated a receipt of \$30.4 million in budget support from development partners, and new government bonds of \$4 million to be issued during the year. Net credit to government however fell over the year driven by a rise in government deposits.

The NRBT expects the domestic economic activity to remain strong 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 in 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.