NATIONAL RESERVE BANK OF TONGA

MONTHLY ECONOMIC REVIEW

Vol. 3 No. 6 Month Ended: June 2016

The Consensus Forecasts in its July 2016 update predicted further policy easing in many Asian countries in the near future due to the Brexit uncertainty and the associated downside risks to the global economy. The outlook for the United States (US), Australia, Japan and noticeably in the UK has been revised down for 2017. Meanwhile, growth in the US, Australia and New Zealand in Q1 remained robust while growth in the Chinese economy continued to slow down in Q2.

Domestically, real sector performances continue to support the real GDP growth of 3.3% estimated for 2015/16 financial year. Total agricultural exports volume rose by 76.5 tonnes (17.5%) over the month owing to higher growth in the exports of late yams *(Figure 1)*. Construction activities grew with rises in individual housing loans and business loans for construction and manufacturing, supporting a strong growth in the secondary production. The trade sector advanced, coinciding with a rise in container registrations by 65 registrations (7.5%) over the month. International arrivals also increased by 3,189 passengers (36.6%) indicating an active tourism sector (*Figure 2*). The financial sector remained strong during the month supported by continued credit growth.

Developments in the labour market continue to be favourable coinciding with the increased economic activities. A significant rise of 22 vacancies in the total number of job advertisements over the month, reflected higher recruitment demands in the Public Administration and Business Services sectors. The labour market is expected to grow in the coming months with the beginning of the new financial year, hence reducing the unemployment rate.

Headline inflation rebounded in June by 0.5%. The continued increase in prices of imported fuel on the back of higher global oil prices drove a 0.7% rise in imported prices. Similarly, the continuous supply shortage of kava-Tonga drove the 0.2% rise in domestic prices.

Annual headline inflation increased by 0.1%, following two consecutive months of deflation (*Figure 3*). A 4.8% rise in domestic prices

Figure 1:

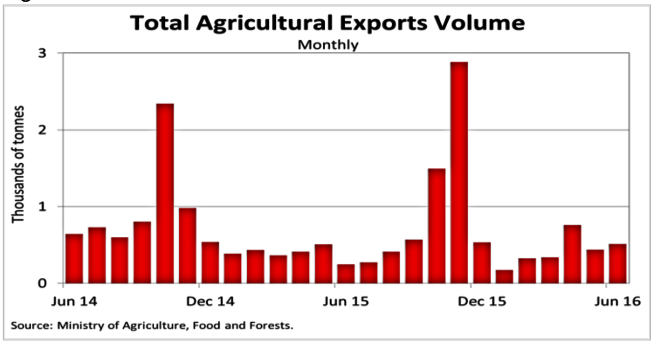


Figure 2:

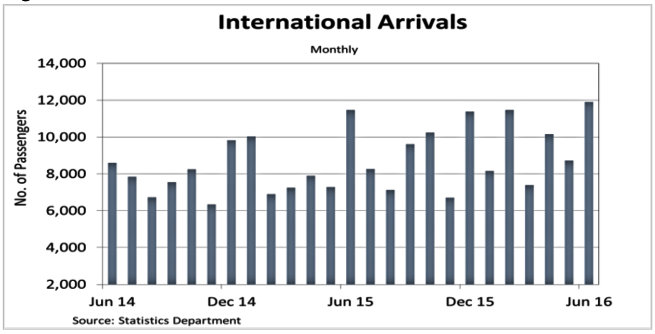
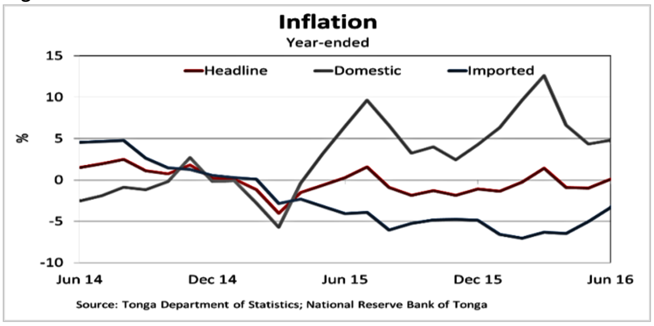


Figure 3:



outweighed a 3.3% decline in imported prices. High domestic prices reflected the sky-rocketing kava-Tonga prices, which has now increased by 137% over the year to $80 per kilo. In addition, domestic food prices rose by 1.3%, reflecting high demand due to the annual church conferences and the special events that were held in June 2016 particularly the celebration of the Tupou College Toloa 150th anniversary. However, the decline in imported prices was due to a fall in prices of imported meat, fruits and vegetables.

The Australian Dollar (AUD) and the New Zealand Dollar (NZD) strengthened against the Tongan Pa'anga (TOP) over the month of June 2016, whilst the U.S Dollar (USD) has weakened. As a result, Tonga's Nominal Effective Exchange Rate (NEER) and Real Effective Exchange Rate (REER) depreciated over the month by 0.9% and 0.6% respectively *(Figure 4)*, maintaining Tonga's price competitiveness amongst that of its major trading partners. Over the year, both the NEER and the REER declined by 6.8% and 7.8% respectively.

Total payments in the Overseas Exchange Transactions (OET) fell in June by $5.4 million (9.8%) to $49.7 million. Import payments declined by $5.8 million over the month driving the fall in total OET payments. This was largely attributed to lower payments for the imports of oil and construction materials despite the rising payments for imports of motor vehicles, wholesale and retail goods.

Total OET receipts reached a new record high in June of $84.9 million, $25.4 million (42.6%) higher than that in May. This was attributed to large inflows of funds from donor partners for budget support and government grants being received before the closing of the fiscal year 2015/16. This brings official transfer receipts to a total of $25.0 million, $14.1 million (129.6%) higher than that in May. Private transfer receipts still remained high at $22.0 million whilst transfers received by non-profit organizations rose by $4.8 million (338.4%) to $6.2 million. Financial account receipts also rose by $3.4 million (38.6%) to $12.2 million which are mostly interbank transfers.

The balance of OET for the month of June, which is the net change to foreign reserves, was therefore a very high surplus of $24.2 million, which is $16.4 million higher than the surplus in May (Figure 5). This reflects the high surplus in the balance of the current account driven by the high inflow of official government transfers and remittance receipts during the month. Official foreign reserves also rose significantly in June to $354.9 million (*Figure6*), equivalent to 10.1 months of import cover, well above the NRBT's minimum range of 3-4 months.[1]

Figure 4:

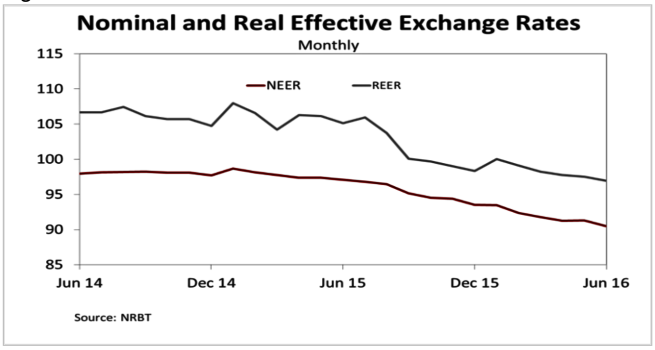


Figure 5:

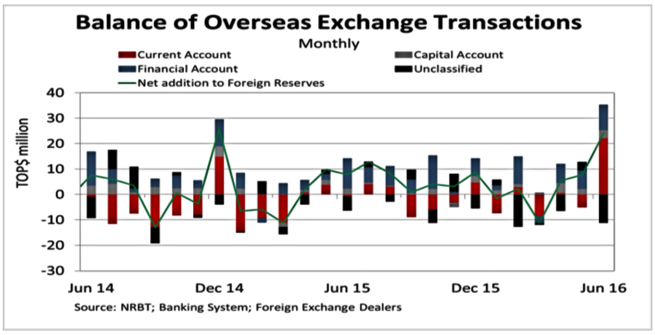
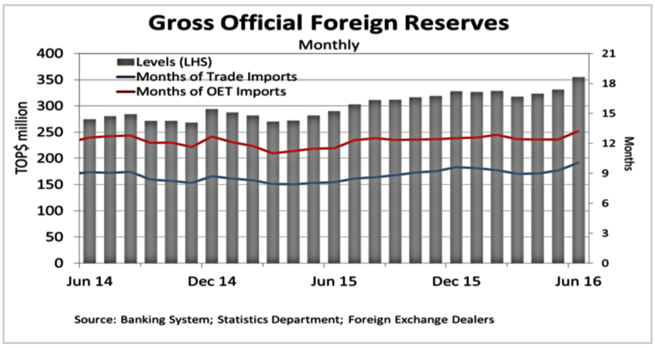


Figure 6:



Broad money increased over the month by $10.1 million (2.2%) to a record high of $470.5 million *(Figure 7)*. This was driven by a $28.5 million (8.5%) increase in net foreign assets, offsetting a $18.5 million (14.6%) decline in net domestic assets. Higher foreign reserves continue to drive the rising net foreign assets while an increase in government deposits explained the fall in net

[1] IMF projects the level of foreign reserves for 2015/16 as equivalent to 7.6 months of imports cover.

domestic assets. The liquidity in the banking system (reserve money) also rose over the month by $7.1 million (2.9%) to $256.5 million, in line with higher deposits. In year ended terms, a significant increase in net foreign assets of $79.3 million (28%) contributed to a $67.2 million (16.7%) rise in broad money.

Total bank lending also rose to another record high of $352.3 million in June, increasing by $3.6 million (1.0%) over the month *(Figure 8)*. Household loans remained as the main driver of higher credit growth, due mainly to continued increase in both housing and vehicle loans. Business loans slightly rose over the month, driven by an increase in loans to the agricultural sector and public enterprises. This was partially supported by low interest rates from the Government Development Loans scheme. Over the year, household loans fuelled a $44.7 million (14.5%) increase in total bank lending, which slightly exceeds NRBT's expectations of 14.4% for 2015/16 financial year.

Weighted average lending rate rose slightly over the month by 0.2 basis points to 7.88%, attributing mainly to an increase in the weighted average other personal lending rate. The weighted average deposit rate also increased over the month by 4.5 basis points to 2.27%, due to increase in all major categories. As a result, the weighted average interest rate spread narrowed by 4.4 basis points to record its lowest level of 5.61%. Annually, the weighted average interest rate spread narrowed by 27.1 basis points from 5.88%. This resulted from declines in both weighted average lending and deposit rates. Total loans to deposit ratio also fell to 75.2% from 76.8% in May, which is below the 80% minimum loan to deposit ratio that is to be effective on the 1st July 2016, indicating excess liquidity for the banking system remains.

Net credit to government fell over the month by $20.4 million, and $24.3 million over the year due mainly to an increase in government deposits. This outcome was due to receipt of budgetary support and government grant funds.

The NRBT in its February 2016 Monetary Policy Statement (MPS) expected the domestic economic activity to slightly ease to 1.9% in 2016/17. This forecast will be revised again and will be published in the August 2016 MPS. The level of foreign reserves is also expected to remain comfortable supported by the expected receipt of remittances and foreign aid, despite the projected rise in imports. Inflationary pressure is also expected to ease in the beginning of 2016/17 then increase to a peak of 4.7% in November 2016 as signs of world oil prices starts to pick up, before falling to 3.06% in January 2017. The banking system remains sound. Moreover, NRBT will closely monitor to ensure the banking system achieves the 80% minimum loan to deposit ratio that was effective on 1st July 2016. The current monetary policy stance therefore remains appropriate in the near term, which is consistent with the assessment by the 2016 IMF Article IV mission. The NRBT will closely monitor the country's economic and fiscal developments and financial conditions to maintain internal and external monetary stability, and to promote a sound and efficient financial system to support macroeconomic stability and economic growth.

Figure 7:

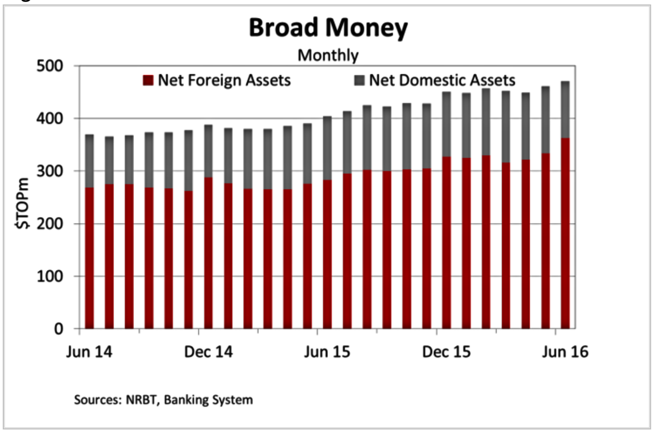


Figure 8: