



Less global expansion as international risks rise

Global economic growth remained stable in August 2018 as reported by the International Monetary Fund yet is expected to soften during the remainder of the year. This stems mainly from rising trade tensions and oil prices. The United States experienced strong economic growth in the first half of the year supported by strengthening labour market conditions and fiscal expenditure. Both Australia and New Zealand announced no changes to their official cash rates¹. Australia showed positive economic growth supported by the global economy and low interest rates. On the other hand, the New Zealand economy slowed driven by lower business confidence and low demand for housing.

Partial economic indicators varies over the month

Sectoral performances in the local economy were mixed over the month. Total agricultural export volumes rose by 432.5 tonnes, reflecting the commencement of the squash season and higher export of root crops. On-going construction activities continued to boost performance in the secondary sector, supported by a rise in business loans for construction and individual housing loans. Electricity production also grew over the month by 0.43 million kilo watt. The total number of container registrations increased by 65 containers followed by additional 3 cargo ships which arrived during the month. This may indicate vibrant activities in the trade sector. The number of air arrival passengers fell by 7.7% as number of flights arrived also declined by 19 flights. However, travel receipts recorded a slight increase of 3.7%.

Consumption activities remains firm as reflected by an increase in the Consumption Tax (CT) collected in August 2018. This coincided with a \$1.5 million rise in total remittances, and a \$0.6 million increase in personal loans. The optimistic outlook for remittance receipts and the continuous increase in new loan commitments to households will support strong consumption spending in the future.

Job vacancies increased

The total number of job advertisements² increased over the month and over the year by 62 and 148 job vacancies respectively due to higher job vacancies from public administration. The rising number of advertisements and the stable performance of the domestic economy is expected to contribute towards a lower unemployment rate³ for Tonga.

Inflationary pressure eases

Headline deflation continued over the month largely driven by favourable movements of imported food and fuel prices which outweighed a rise in price of imported tobacco. A \$0.54 decline in the price of chicken pieces was due to the removal of excise tax in July whilst the further rise in excise tax of tobacco reflected a \$1.94 increase in the price of Winfield Blue. The continued abundant supply of local fruits

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Aug-18	Jul-18	Aug-18	Jul-18
Headline Inflation (%)	-0.6	-0.1	5.7	6.1
Domestic prices	0.1	-0.9	8.4	6.2
Imported prices	-1.1	0.6	3.6	6.0

Source: Statistics Department

and vegetables drove domestic food prices lower over the month but was offset by a rise in the price of local labour (tongāue) rates. Annual headline inflation

has slowed to 5.7% from a 6.1% in July 2018 and slightly above the 5.5% recorded in August 2017. Higher prices in local commodities over the year were noted for

Table 2: Items contributing to domestic inflation

Items (\$ per kg)	Monthly			Annual	
	Aug-18	Jul-18	Growth	Aug-17	Growth
Capsicum	\$7.94	\$20.41	-\$12.47	\$8.32	-\$0.38
Tomatoes	\$3.81	\$6.46	-\$2.65	\$3.75	\$0.06
Head Cabbage	\$2.09	\$3.44	-\$1.35	\$1.14	\$0.95
Kumala	\$2.62	\$3.14	-\$0.52	\$2.88	-\$0.26
Pineapple	\$12.89	\$7.90	\$4.99	\$14.04	-\$1.15
Watermelon	\$3.27	\$2.85	\$0.42	\$1.96	\$1.31
Octopus	\$15.95	\$18.44	-\$2.49	\$15.05	\$0.90
Eggs	\$17.68	\$17.13	\$0.55	\$16.63	\$1.05
Cassava	\$1.09	\$0.70	\$0.39	\$0.53	\$0.56

Source: Statistics Department

food, kava-Tonga, household supplies and house maintenance goods. Additionally, imported goods whose price rose included fuel, tobacco and clothing supplies.

Exchange Rates remained stable

Table 3: Exchange Rates

	Monthly			Annual	
	Aug-18	Jul-18	% Growth	Aug-17	% Growth
Nominal Effective Exchange Rate Index	91.5	91.1	0.5	91.8	-0.3
Real Effective Exchange Rate Index	107.1	107.7	-0.5	104.7	2.3

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) index slightly increased over the month which indicates that imports were less expensive relative to last month due to the depreciation of AUD, NZD and GBP against the TOP which outweighed the appreciation of the USD, FJD, CNY, JPY and EUR.

Table 4: Bilateral Exchange Rates

	Aug-18	Jul-18	Aug-17
USD/TOP	0.4377	0.4416	0.4616
AUD/TOP	0.6030	0.5961	0.5841
NZD/TOP	0.6590	0.6471	0.6412
FJD/TOP	0.9203	0.9225	0.9352
JPY/TOP	40.6088	49.0286	50.9214
GBP/TOP	0.3365	0.3362	0.3572
EUR/TOP	0.3753	0.3771	0.3881
CNY/TOP	2.9958	3.0095	3.0440

Source: National Reserve Bank of Tonga

The headline deflation over the month of August 2018 led to a fall in the Real Effective Exchange Rate (REER) index signaling Tonga's exports gaining competitiveness relative to its trading partners over the month. Over the year, the higher REER reflected Tonga's higher headline inflation rate in comparison to its trading partners, which may impact the international competitiveness of the Tongan exports of goods and services.

Foreign Reserves movement slowed

The overall balance of Overseas Exchange Transaction (OET) recorded a deficit over the month compared to a surplus in the previous month. This was driven by an increase in payments for service and import purposes. Consequently, the official foreign reserves declined to

¹ Monetary Policy Statement August 2018

² Based on data collected by the Reserve Bank

³ Unemployment rate of 1.1% refer to not working, available & looking for work, 16.4% refer to not working, available & willing to work and 34.8% refer to including subsistence workers



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\$475.0 million, which is equivalent to 7.7 months of import cover.

Table 5: Foreign Reserves

	Monthly			Annual	
	Aug-18	Jul-18	% Growth	Aug-17	% Growth
Foreign Reserves (\$ in million)	475.0	476.5	-0.3	405.0	17.7
Import Coverage (months)	7.7	7.8		7.4	

Source: National Reserve Bank Tonga

Higher payments for shipping freights by private and airline companies drove the rise in service payments whereas oil payments contributed to higher import payments. Majority of OET payments made during the month were made by private companies, indicating growth in the private sector. The official transfer receipts also declined over the month particularly for the public sector. However, the OET balance in year ended terms recorded a higher surplus due to surpluses in all accounts with capital account recorded the highest. This stemmed from higher official grants for investment projects or capital expenditures mainly for constructions for government. Higher interbank transfers led the financial account surplus while the import payments for wholesale & retail goods drove the lower surplus in the current account.

Table 6: Overseas Exchange Transactions

	Monthly			Annual		
	Aug-18	Jul-18	% Growth	Aug-18	Aug-17	% Growth
Overall Balance	-1.5	7.7	-119.2	70.0	38.8	80.5
Current Account	-5.7	0.8	-789.3	11.1	43.1	-74.2
Merchandise Trade	-36.7	-36.7	0.1	-390.1	-354.1	10.2
Services	2.2	5.9	-63.4	22.2	39.1	-43.2
Income	1.9	1.9	-0.1	-1.9	-20.4	-90.5
Transfers	27.0	29.7	-9.0	381.0	378.4	0.7
Capital Account	2.4	3.8	-38.5	39.8	32.4	22.5
Financial Account	1.8	3.1	-41.4	19.1	-36.8	48.1

Source: Banking Systems

Broad Money remained high despite a slight decline

Table 7: Broad Money

	Monthly			Annual	
	Aug-18	Jul-18	% Growth	Aug-17	% Growth
Broad money (\$ in million)	606.0	606.1	-0.02	552.3	9.7
Net Foreign Asset	494.1	497.5	-0.7	429.0	15.2
Net Domestic Asset	112.2	108.9	3.0	123.4	-9.1

Source: Banking System, National Reserve Bank of Tonga

The net foreign assets declined which more than offsets an increase in net domestic asset. Net credit to Government rose over the month due to fall in government deposits. Over the year, broad money rose due to a significant growth in foreign reserves and corresponded to the increase in net foreign assets. The receipts of budgetary support, grants and cyclone relief funds from development partners and higher remittances during the year contributed to this annual growth.

Liquidity continued to rise

Table 8: Reserve money

	Monthly			Annual	
	Aug-18	Jul-18	% Growth	Aug-17	% Growth
Reserve money (\$ in million)	334.2	332.3	0.6	282.9	18.2

Source: Banking System, National Reserve Bank of Tonga

Banks maintained a strong capital position which was supported by their comfortable profitability, high liquidity, and low level of non-performing loans. Higher deposits by the commercial banks to the Reserve Bank's vault contributed to expand in reserve money. The banks' total loans to deposit ratio grew from 70.9% last month to 71.5%

this month, reflecting higher lending outweighing growth in deposits. This continued to remain below the 80% minimum loan to deposit ratio which indicates excess liquidity in the banking system and that there is capacity for further lending by the banks.

Lending to businesses and households rises

Table 9: Total Lending

	Monthly			Annual	
	Aug-18	Jul-18	% Growth	Aug-17	% Growth
Total Lending (\$ in million)	457.5	452.9	1.0	415.6	10.1
Business lending	205.7	202.7	1.5	181.8	13.1
Household lending	251.1	249.4	0.7	232.6	8.0
Other lending	0.700	0.820	-14.6	1.19	-41.1

Source: Banking System, National Reserve Bank of Tonga

Total banks' lending increased over August as a result of higher business loans to public enterprises, wholesale & retail, agriculture and construction sectors. Lending to households continued to be driven by higher housing loans, and supported by growth in personal loan. Over the year, total banks' lending rose owing to an increase in individual housing loans. The consistent rise in household loans continued to reflect persistent increasing demand of households and their capacity to access loans. Increased lending to the wholesale & retail, tourism, construction and fisheries sectors also contributed to the annual rise in total business loans. These movements supported credit growth and the economic activities in the business sectors. Low interest rates from the Government Development Loans partially supported the higher lending in business sectors. This coincided with strong domestic economic activities evident throughout the year.

Weighted average interest rate spread widened further

Table 10: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Aug-18	Jul-18	Growth (bps)	Aug-17	Growth (bps)
Weighted Average Banks Deposit Rate (%)	1.992	2.019	-2.7	2.090	-9.9
Weighted Average Banks Lending Rate (%)	8.076	8.062	1.4	7.828	24.7
Weighted Average Interest Rate Spread (%)	6.084	6.043	4.1	5.738	34.6

Source: Banking System, National Reserve Bank of Tonga

The widening of the weighted average interest rate spread over the month and year reflected the rise in the weighted average lending rate and the decline in the weighted average deposit rate. Lending rates for businesses rose for the construction and tourism sectors and also housing loans. The weighted average deposit rate however declined due to slightly fall in all deposit rates categories.

Outlook

In light of the above developments, Tonga's economic performance remain positive in the medium term. The level of foreign reserves is also expected to remain at comfortable levels, supported by expected higher receipts of budgetary support and grant funds from development partners and expected higher receipts of remittances. This will be partially offset by the anticipated increase in imports and the Government's external loan repayments. Inflation is expected to fall below the Reserve Bank's inflation reference rate of 5% per annum at the end of 2018. The Reserve Bank will continue to closely monitor developments in the domestic and global economies to ensure financial and macroeconomic stability are maintained and to change its monetary policy setting where necessary to support its monetary policy objectives.