

Global slowdown continues in December

The slowdown reported by the International Monetary Fund (IMF) last month is still being reflected in performances of advanced economies such as the United States. The United States' Commerce Department recorded a GDP growth of 3.4% for its third quarter of 2018 and is the third revision. Despite the resilience in growth, the downward revision reflected a slowdown in consumer spending and exports. The Reserve Bank of Australia reported in its Monetary Policy Decision statement for December that the economy is performing well due to positive business conditions and rise in non-mining business investments. New Zealand's economy was reported by New Zealand Statistics to have slowed to an annual rate of 2.6% at the end of September 2018. This was driven largely by a fall in construction activity and manufacturing.

Positive domestic performance over the month

Sectoral performances of the domestic economy ended on a positive note for the year 2018. Marine exports volumes more than doubled (55.0 metric tonnes) in December driven mostly by exports of tuna. Fishing vessels reported increased catch which coincided with a \$0.2 million rise in fisheries export receipts. Harvesting season for root crops led to abundant local food supply, further leading to a decline in local food prices recorded during the month. Also supporting the agricultural sector was a \$0.3 million rise in agricultural export proceeds mainly from squash export.

Moreover, the on-going construction activities continued to boost the performance of the secondary sector, supported by a 7.1% growth in business construction loans followed by a 0.6% rise in lending for individual housing. Additionally, a 13% (0.75 million kW) increase in electricity production also depicts high economic activity.

Indicators of the tertiary sector were generally positive, starting with Banks' total lending rising by \$10.0 million (2.1%) fueling activities in both the public enterprises and private business sectors. Total international air arrivals reached its highest for the year, increasing by 51.1% and coincided with a \$2.8 million rise in travel receipts, as this is the month where we expect the most visitors for the Christmas festivities. Container registrations, however, declined by 17% (230 containers) due mainly to a fall in private containers as there were a lower number of cargo ships (by 3 ships) that arrived in Tonga. However, the high number of container registration for the previous months indicates that businesses were already well stocked for the month of December.

Consumption activities was vibrant as consumption tax collected increased coupled with a \$4.7 million rise in remittances received. In addition to the Christmas festivities, other celebrations such as church events, weddings, and family reunions warrants higher receipts of gift transfers and more consumption spending to take place.

Job advertisements remain positive over the year

Job vacancies¹ slowed in December as it declined by 37% (13 job vacancies) mostly in public administration. Annual movements, however, rose by 56% (149 vacancies) which will eventually contribute to lower unemployment rates.

Annual inflation finally falls below the 5% reference rate

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Dec-18	Nov-18	Dec-18	Nov-18
Headline Inflation (%)	-0.9	-0.4	4.8	6.5
Domestic prices	-0.5	-0.3	7.1	8.9
Imported prices	-1.2	-0.4	2.9	4.6

Source: Statistics Department

The monthly deflation continued to December 2018, where overall price level declined by 0.9% due to favorable movements in both local and imported commodity prices. Domestic food and tobacco declined by 1.5% and 0.4% respectively. Local food such as root crops, taro leaves, and eggs recorded a decline in prices and reflected the harvesting season of early yams. The decline in imported prices was largely driven by the prices of petrol and diesel which declined by 6.5% and 4.9% respectively due to lower global prices. This was followed by meat products such as lamb flaps and chicken pieces.

Table 2: Items contributing to annual domestic inflation

Items (\$ per kg)	Monthly			Annual	
	Dec-18	Nov-18	Change	Dec-17	Change
Octopus	\$31.95	\$18.34	\$13.61	\$20.59	\$11.36
Carrots	\$4.08	\$3.08	\$1.00	\$1.87	\$2.21
Tomatoes	\$4.90	\$2.96	\$1.94	\$2.73	\$2.17
Tuna	\$16.00	\$17.31	-\$0.11	\$14.00	\$2.00
Yams - late	\$3.80	\$3.41	\$0.39	\$2.45	\$1.35
Cockles (to'o)	\$5.50	\$5.36	\$0.14	\$4.48	\$1.02
Stringed fish (mixed)	\$9.00	\$8.74	\$0.26	\$8.00	\$1.00
Cassava	\$1.38	\$1.52	-\$0.14	\$0.53	\$0.85
H/cabbage	\$2.47	\$1.68	\$0.79	\$1.62	\$0.85
Sweet potato	\$2.72	\$2.37	\$0.35	\$1.97	\$0.75

Source: Statistics Department

Additionally, the annual headline inflation slowed to 4.8% in December 2018 after recording its highest level for the year in November at 6.5% and 6.1% in December 2017.

Headline inflation has stayed above the reference rate since July 2018. The domestic component of inflation contributed 3.2 percentage points to the annual headline inflation attributed to the seasonality of local food and increase in the price of tobacco as the main contributors, outweighing the annual decline in prices of local communication. The remaining 1.6 percentage points is attributed to the imported component of inflation in which higher imported prices were noted for tobacco & alcoholic beverages, fuel, clothing, liquid petroleum gas, paint, and iron roofing.

Exchange Rates slightly weakens

Table 2: Exchange Rates

	Monthly			Annual	
	Dec-18	Nov-18	% Growth	Dec-17	% Growth
Nominal Effective Exchange Rate Index	92.0	92.1	-0.2	91.3	0.8
Real Effective Exchange Rate Index	107.7	108.6	-0.8	103.3	4.3

Source: National Reserve Bank of Tonga

Table 3: Bilateral Exchange Rates

	Dec-18	Nov-18	Dec-17
USD/TOP	0.4397	0.4446	0.4536
AUD/TOP	0.6264	0.6091	0.5821
NZD/TOP	0.6560	0.6495	0.6404
FJD/TOP	0.9421	0.9344	0.9322
JPY/TOP	48.6286	50.4866	51.2024
GBP/TOP	0.3478	0.3483	0.3374
EUR/TOP	0.3841	0.3912	0.3795
CNY/TOP	3.0191	3.0866	2.9635

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) index fell slightly over the month due to the appreciation of the AUD, NZD, and FJD against the TOP. The Real Effective Exchange Rate (REER) index

¹ Based on data collected by the Reserve Bank

also declined reflecting the fall in inflation over the month. Over the year, the NEER increased slightly whilst the REER increased more reflecting Tonga's higher headline inflation rate in comparison to its trading partners.

December foreign reserves another record high

Table 4: Foreign Reserves

	Monthly			Annual	
	Dec-18	Nov-18	% Growth	Dec-17	% Growth
Foreign Reserves (\$ in million)	478.5	468.7	2.1	422.5	13.3
Import Coverage (months)	7.6	7.4		7.6	

Source: National Reserve Bank Tonga

Budget support and net inflow from foreign exchange deals with commercial banks due to excess fund receipts from remittances, pushed foreign reserves to another record high in December 2018 of \$478.5 million equivalent to 7.6 months of imports cover.

Table 5: Overseas Exchange Transactions

	Monthly			Annual		
	Dec-18	Nov-18	% Growth	Dec-18	Dec-17	% Growth
Overall Balance	9.8	11.4	-13.4	56.0	43.7	28.3
Current Account	6.6	20.0	-67.2	26.8	12.2	120.0
Merchandise Trade	-31.8	-32.6	-2.5	-412.5	-366.7	12.5
Services	3.5	4.2	-16.7	29.5	33.2	-11.1
Income	1.5	1.2	31.9	5.5	-17.0	-132.6
Transfers	33.3	47.2	-29.5	404.3	362.7	11.5
Capital Account	1.9	1.0	93.4	27.8	43.7	-36.4
Financial Account	1.4	-9.6	-114.3	1.4	-12.3	-111.4

Source: Banking Systems

The current account continued to record a surplus in December albeit lower than the previous month. This was due to a decline in receipts of transfers particularly official transfers following a large influx of budget support funds in the previous month. Private transfer receipts also increased over the month which is mostly remittances. Additionally, travel receipts also rose by 30% however this partially offset by an 18% rise in service payments.

Annually, the OET surplus balance recorded was higher compared to December of last year. Higher receipts over the year were mostly driven by official receipts such as budget support and Government grants. However, the merchandise trade deficit continues to widen given higher payments for import (11% increase) of wholesale and retail goods, oil, and motor vehicles, compared to lower export receipts (9% decrease).

However, the capital account continued to contribute the most to the overall OET surplus balance. This resulted from higher official grants for investment projects and capital expenditures (mostly for government and public works). The financial account recorded a surplus in contrast to the deficit last year due to an increase in account transactions by the commercial banks.

Broad money rose in December

Table 6: Broad Money

	Monthly			Annual	
	Dec-18	Nov-18	% Growth	Dec-17	% Growth
Broad money (\$ in million)	605.3	592.3	2.2	560.6	8.0
Net Foreign Asset	502.1	489.7	2.5	441.8	13.6
Net Domestic Asset	103.5	103.0	0.5	119.0	-13.0

Source: Banking System, National Reserve Bank of Tonga

Broad money increased over the month driven mostly by a rise in net foreign assets. In particular, higher foreign

reserves in December led the overall rise. Meanwhile, net domestic assets contributed slightly to the monthly increase due to higher government deposits. Over the year, receipts of budgetary support, grants, and cyclone relief funds from development partners and more remittances supported higher foreign reserves. This led to the yearly rise in broad money.

Liquidity increases yet ratio improves in December

Table 7: Reserve money

	Monthly			Annual	
	Dec-18	Nov-18	% Growth	Dec-17	% Growth
Reserve money (\$ in million)	324.7	317.3	2.3	295.9	9.7

Source: Banking System, National Reserve Bank of Tonga

The banking system remained sound throughout December 2018 as banks continued to maintain a strong capital position supported by adequate profits. The increase in currency in circulation reflects the high demand of the public for cash. This drove the overall rise in liquidity whilst offsetting lower deposits by the commercial banks to the Reserve Bank's vault. The banks' total loans to deposit ratio rose from 74.9% in the previous month to 75.1% this month reflecting the increase in loans for December.

Despite this ratio being below the 80% minimum loan to deposit ratio, the commercial banks have respectively improved on this ratio over the year due to the active lending activities utilizing the capacity available for further lending.

Lending to businesses drive credit growth up

Table 8: Total Lending

Lending	Monthly			Annual	
	Dec-18	Nov-18	% Growth	Dec-17	% Growth
Total Lending (\$ in million)	479.9	469.9	2.1	436.7	9.9
Business lending	219.4	211.2	3.9	191.7	14.5
Household lending	260.1	258.1	0.8	244.1	6.6
Other lending	0.4	0.6	-27.6	1.0	-57.9

Source: Banking System, National Reserve Bank of Tonga

Both monthly and annual lending increased driven largely by higher lending to businesses and households. During December, most of the lending was for businesses particularly transport, professional and other services, and construction sectors. Household loans also contributed to the monthly rise and mainly due to housing and other personal loans.

Over the year, business lending grew due to an increase in loans for the public enterprises, wholesale & retail, transport, and tourism sectors whilst household lending rose driven solely by more individual housing loans. The low-interest rates offered on the Government Development Loan scheme partially contributed to the monthly and annual movements and also coincided with strong domestic economic activities evident throughout the year. It is expected that loans will continue to increase driven by the banks excess liquidity and capacity to lend throughout the year.

Weighted average interest rate spread widened

Table 9: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Dec-18	Nov-18	Growth (bps)	Dec-17	Growth (bps)
Weighted Average Banks Deposit Rate (%)	1.897	1.979	-8.2	2.160	-26.3
Weighted Average Banks Lending Rate (%)	8.121	8.094	2.7	7.955	16.6
Weighted Average Interest Rate Spread (%)	6.224	6.115	10.9	5.795	42.9

Source: Banking System, National Reserve Bank of Tonga

The weighted average interest rate spread widened in December due to a rise in the weighted average lending rate mainly for households' housing loans and business loans to the manufacturing and trade sectors, and a decline in weighted average deposit rates. However, the volume of loans also increased contributing to the overall rise of the weighted average lending rate. The weighted average deposit rate, on the other hand, declined due to lower term deposit rates whilst savings and demand deposit rates remained stable. Annually, the weighted average interest rate spread widened due to an increase in weighted average lending rates and a decrease in the weighted average deposit rate. The increased weighted average lending rate stemmed from higher rates for business loans to the manufacturing, trade, and tourism sectors. On the other hand, the weighted average deposit rates declined due to a decrease in demand and term deposit rates.

Outlook

Given the developments in December, the Reserve Bank's outlook for strong domestic economic activity remains in the medium term. The level of foreign reserves is expected to remain at comfortable levels, supported by expected receipts of budgetary support and grant funds from development partners, on-going receipts of remittances and the deferment of the principal loan repayment to the EXIM Bank of China. This will be partially offset by the anticipated increase in imports. Inflation is expected to remain below the Reserve Bank's inflation reference rate of 5% per annum in 2019. 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.