



## MONTHLY ECONOMIC REVIEW

Vol. 5

No. 3

Month Ended: March 2018

Developments among Tonga's major trading partners remained largely positive. Both Australia and New Zealand reported their GDP growth of 2.7% and 2.9% respectively for the year ended to December 2017. For Australia, public investment and trade supported economic growth whilst for New Zealand, the services industries drove economic growth. The United States (U.S.) also expanded at 2.9% over the year to December 2017 fuelled significantly by consumer spending. This supported the Federal Reserve decision to raise interest rates due to expectations that tax cuts and government spending will boost the economy and inflation. Overall, these trends are expected to continue in the near term, however market volatility remain.

The Statistics Department recently released Tonga's 2016-17 Real Gross Domestic Product (GDP) of 5.0% reaching its highest growth since 1998-99. Over the month, recovery works from the destruction caused by Tropical Cyclone (TC) Gita contributed to driving domestic economic activities. Partial economic indicators were positive over the month. The total agricultural exports increased by 335.5 tonnes mainly driven by a rise in exported volume of root crops and coconuts. Activities in the secondary industry remained positive supported by loans to respective sectors in the industry. Individual housing and business manufacturing loans increased by 0.5% and 2.8% respectively. In the tertiary sector, total loans slightly rose by 0.9% over the month. Nonetheless, container registrations rose by 493 containers as both private and business containers increased by 339 and 154 respectively, reflecting the in-kind donations and picking up of trade activities following the cyclone. International air arrivals also increased by 9.0%.

As a partial indicator of employment, the total number of job advertisements declined over the month of March 2018 by 32 vacancies, mainly for Public Administration. In year ended terms, total job advertisements also fell by 32 vacancies.

The official headline inflation rate for March 2018 is yet to be released by the Statistics Department. However, the impact of TC Gita in February on the domestic food supply is expected to push domestic inflation upward. Over the year, the headline inflation is anticipated to be around 4.0% compared to 3.4% in February 2018. The anticipated annual headline inflation is due to higher expectations in the prices of food, transportation, tobacco, alcohol and kava-Tonga.

In March 2018, the Tongan Pa'anga depreciated against the USD and NZD, leading to a fall in the Nominal Effective Exchange Rate (NEER) index. The USD appreciated due to favourable economic data and escalating trade tension whereas the NZD strengthened mainly on improvements in their fourth quarter terms of trade. On the other hand, the Real Effective Exchange Rate (REER) index slightly

rose over the month and year which reflected Tonga's higher headline inflation rate relative to its trading partners, which may impact the international competitiveness of the Tongan exports of goods and services.

Table 1: Exchange Rates

	Monthly			Annual	
	Mar-18	Feb-18	% Growth	Mar-17	% Growth
Nominal Effective Exchange Rate Index	90.2	90.3	-0.2	91.4	-1.4
Real Effective Exchange Rate Index	104.7	104.0	0.6	104.2	0.5

Sources: NRBT

In March 2018, the overall Overseas Exchange Transaction (OET) balance recorded a deficit of \$0.3 million, leading to a slight decline in the official foreign reserves to \$447.7 million. This is equivalent to 8.0 months<sup>1</sup> of import cover, which is above the Reserve Bank's minimum range of 3-4 months.

Table 2: Foreign Reserves

	Monthly			Annual	
	Mar-18	Feb-18	% Growth	Mar-17	% Growth
Foreign Reserves (\$ in million)	447.7	448.0	-0.1	366.0	22.3
Import Coverage (months)	8.0	8.2		6.7	

Sources: NRBT

The overall OET balance deficit was due mainly to the deficit in the current account offsetting the surplus in both the capital and the financial accounts. The current account deficit was attributed to higher payments for professional services and imports of wholesale and retail goods in addition to lower receipts over the month. The surplus in the capital account was due to higher official and private grant receipts while higher interbank transfer receipts drove the surplus in the financial account.

Table 3: Overseas Exchange Transactions

	Monthly			Annual		
	Mar-18	Feb-18	% Growth	Mar-18	Mar-17	% Growth
<b>Overall Balance</b>	<b>-0.3</b>	<b>23.9</b>	<b>-101.3</b>	<b>81.6</b>	<b>48.7</b>	<b>67.6</b>
<b>Current Account</b>	<b>-12.3</b>	<b>21.8</b>	<b>-156.5</b>	<b>24.7</b>	<b>37.6</b>	<b>-34.4</b>
Merchandise Trade	-32.4	-26.2	23.9	-379.0	-333.5	13.6
Services	-4.3	10.8	-139.5	46.8	17.8	162.7
Income	-0.9	0.9	-208.5	-18.0	-1.5	1082.4
Transfers	25.4	36.3	-30.1	374.9	354.8	5.7
<b>Capital Account</b>	<b>1.0</b>	<b>2.7</b>	<b>-63.9</b>	<b>42.6</b>	<b>25.7</b>	<b>66.2</b>
<b>Financial Account*</b>	<b>11.0</b>	<b>-0.6</b>	<b>-2100.6</b>	<b>14.3</b>	<b>-14.5</b>	<b>-198.7</b>

\* Includes unclassified transactions

Source: Banking System

Annually, the surplus in the overall OET balance rose significantly due to surpluses in all accounts. The surplus in the capital account was the largest contributor and was higher than the surplus of last year, due mainly to higher official and private grant receipts for investment projects or capital expenditures. The current account surplus was however lower than that of last year due to higher wholesale & retail import payments. The financial account recorded a surplus following a deficit in the previous year, due mainly to higher interbank receipts.

Broad money slightly rose by 0.1% over March and increased further by 11.0% over the year. The monthly rise resulted from an increase in net domestic assets offsetting

<sup>1</sup> Method of calculation changed in February 2017 to include imports of both goods & services (previous method used imports of goods only)



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a decline in net foreign assets. More specifically, net domestic credit drove the rise in net domestic assets whilst foreign reserves and other foreign assets triggered the decline in the net foreign assets. The annual movement was driven significantly by the increase in net foreign assets, particularly the foreign reserves and had offset the decrease in net domestic assets.

Table 4: Money Supply

	Monthly			Annual	
	Mar-18	Feb-18	% Growth	Mar-17	% Growth
Money Supply (\$ in million)	558.7	558.2	0.1	503.6	11.0
Net Foreign Asset	461.7	468.1	-1.4	389.7	18.5
Net Domestic Asset	97.2	90.3	7.6	114.1	-14.9

Source: Banking System, NRBT

Liquidity in the banking system (reserve money) increased over March to \$308.9 million. This was solely driven by a \$12.0 million increase in deposits by the commercial banks to the Reserve Bank vault which coincided with a decline in currency in circulation. The required reserves also rose further supporting the increased liquidity. In year ended terms, liquidity also grew due to rises in currency in circulation and required reserves. The banks' total loan to deposit ratio (including Government Development Loan (GDL) scheme) slightly increased to 76.3% from 76.2% last month, reflecting a slightly higher increase in total deposits relative to total loans. Total loans to deposit ratio (excluding GDL) remained stable at 74.7% in March due to proportionate growth in both total deposits and total loans. It continues to remain below the 80% minimum loan to deposit ratio which indicates excess liquidity in the banking system remains and that there is capacity for further lending by banks.

Table 5: Total Lending (including GDL)

Lending	Monthly			Annual	
	Mar-18	Feb-18	% Growth	Mar-17	% Growth
Total Lending (\$ in million)	443.6	439.5	0.9	391.2	13.4
Business lending	199.4	196.1	1.7	168.7	18.2
Household lending	243.3	242.6	0.3	221.3	9.9
Other lending	0.9	0.9	-0.2	1.2	-25.9

Source: Banking System, NRBT

Total banks' lending (including GDL) increased over the month due to more loans to businesses (wholesale and retail, agriculture, and manufacturing sectors) and households (housing loans). Total lending (excluding GDL) also increased by \$3.4 million to \$434.6 million. Over the year, total banks' lending (including GDL) rose significantly as a result of more lending to both businesses and households. Business loans rose particularly for the public enterprises, and the wholesale & retail, and services sectors. Household loans also rose as demand for housing loans increased. Lending (excluding GDL) also grew over the year by \$53.4 million. These movements continued to coincide with the strong domestic economic activities

evident throughout the year. Low interest rates from the GDL scheme partially supported the credit growth.

The weighted average interest rate spread widened over March and over the year to 5.805%. The monthly rise was due to an increase in the weighted average lending rate (higher business lending rates particularly for manufacturing, transport, and trade sectors as well as household lending rates for vehicles and other personal loans) which was partly offset by a rise in the weighted average deposit rate (higher deposit rates for all deposit categories). Over the year, the weighted average interest rate spread widened due to the increase in the weighted average lending rate (increase in both business and households lending rates) and the decline in the weighted average deposit rates.

Table 6: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Mar-18	Feb-18	Growth (bps)	Mar-17	Growth (bps)
Weighted Average Banks Deposit Rate (%)	2.164	2.161	0.3	2.203	-3.9
Weighted Average Banks Lending Rate (%)	7.969	7.952	1.7	7.845	12.4
Weighted Average Interest Rate Spread (%)	5.805	5.791	1.4	5.642	16.3

Source: Banking System, NRBT

Net credit to Government rose over the month by \$7.3 million due to fall in government deposits. This reflected higher external debt service payments and other government expenditures during the month. Net credit to Government however fell over the year by \$66.1 million due to receipts of cyclone relief funds, grants and project funds and improved government revenue collection during the year.

The growth outlook for Tonga remains positive in the years ahead. The Reserve Bank will revise its growth estimates to be published in its Monetary Policy Statement. The level of foreign reserves is expected to remain at comfortable levels well above the minimum range of 3-4 months of import cover supported by expected higher receipts of remittances and foreign aid. This will be partially offset by the projected rise in imports and the commencement of the Government's principal loan repayment to the EXIM Bank of China. Inflation is anticipated to remain below the Reserve Bank's inflation reference rate of 5% per annum in 2018. In light of the above developments and that the banking system remained sound, the Reserve Bank Board maintained its current accommodative monetary policy measures. The Reserve Bank will remain vigilant and continue to closely monitor developments in the domestic and global economy for early signs of vulnerability or overheating of the economy. Furthermore, the Reserve Bank will continue to update its monetary policy setting to maintain internal and external monetary stability and to promote a sound and efficient financial system, in order to support macroeconomic stability and economic growth.