

Trade uncertainties continue to impact global growth

The IMF reported a continued slowdown in global growth since the previous decade. The negative spillover effect of the US-China trade tensions intensified the slowdown currently in place driving the US growth downwards. For Tonga's other trading partners, the Reserve Bank of Australia held its cash rate unchanged at 0.75% in December 2019, maintaining low-interest rates with the intention to boost domestic economic activities and consumer confidence and in response to the bushfire crisis. Meanwhile, the New Zealand Treasury reported that the New Zealand economy experienced a slower period of economic growth of 2.4% in the 2018/19 financial year compared to a 3.2% growth in the previous financial year. This is attributed to lower household spending and the export of services with subdued business investments.

Improved outcomes for domestic activities

The primary sector showed mixed performances in December 2019. Agricultural export volumes continued to decline over the month by 1,979.7 tonnes (68.8%) driven by lower squash exports, yet still rose over the year by 2,335.9 tonnes (24.1%). Proceeds for agricultural and marine exports both increased by \$0.2 million (40.1%) and \$0.2 million (20.6%), respectively. However, proceeds from agricultural exports declined over the year by \$2.5 million (22.4%), while marine export proceeds continue to rise by \$3.2 million (49.5%).

The industry sector performance was mostly positive. Lending for individual housing and business construction increased by \$1.1 million (0.5%) and \$1.1 million (11.1%) respectively in December, indicating growth in construction activities. This is also supported by higher payments for imports of construction materials over the month by \$0.4 million (31.1%). Both electricity consumption and production also rose by 18.1% and 12.1%, respectively supporting the utility sector.

December is a busy month for Tonga as it receives many visitors for the holiday season benefitting the tertiary sector. Total international air arrivals increased by 2,329 passengers (27.0%) during the month. Consequently, travel receipts also rose by \$1.1 million (9.8%). However, air arrival passengers are 15.7% lower than the total in December 2018, as there were a lower number of flights compared to the previous year. Container registrations increased by 331 (29.3%), as both private and business containers rose by 307 (83.9%) and 24 (3.1%) registrations respectively. Import payments for wholesale and retail goods also rose by \$2.4 million (12.3%) during the month supporting trade and consumption. Additionally, total vehicle registrations also rose by 39 registrations (2.8%) due to more registrations of cars and other light vehicles.

Fewer job advertisements in December

The total number of job advertisements fell in December 2019 by 20 job vacancies (37.7%), owing mostly to the Government's 2 weeks Christmas vacation. Nevertheless, advertised vacancies rose by 72 (17.4%) advertisements over the year, mostly in the services sector for public administration, which may contribute to lower the unemployment rate in Tonga.

Price increase for December

Table 1: Inflation Rates

| Prices | Monthly | | Annual | |
|-------------------------------|------------|-------------|------------|------------|
| | Dec-19 | Nov-19 | Dec-19 | Dec-18 |
| Headline Inflation (%) | 0.2 | -0.5 | 1.2 | 4.8 |
| Domestic prices | 0.7 | -0.2 | 0.1 | 7.1 |
| Imported prices | -0.3 | -0.8 | 2.1 | 2.9 |

Source: Statistics Department

Headline inflation rose by 0.2% over the month as domestic prices increased by 0.7% while imported prices fell by 0.3%. Domestic prices rose driven by the 3.5% increase in local food, outweighing the decline in Tongan tobacco and kava Tonga prices, which fell by 2.2% and 6.1%, respectively. Imported prices dropped attributing to the fall in prices for maintenance services (2.2%), imported food (0.8%), and alcoholic beverages (0.3%).

Table 2: 'Average prices of selected domestic items'

| Items (\$ per kg) | Unit | Monthly | | | Annual | |
|-----------------------|--------|---------|---------|---------|---------|--------|
| | | Dec-19 | Nov-19 | Change | Dec-18 | Change |
| Lu | 1kg | \$6.97 | \$5.01 | \$1.96 | \$4.60 | \$2.37 |
| Cockles (to'o) | 1kg | \$7.69 | \$6.07 | \$1.62 | \$5.50 | \$2.19 |
| Eggs | 1 tray | \$16.54 | \$16.79 | -\$0.25 | \$15.17 | \$1.37 |
| H/Cabbage | 1kg | \$3.74 | \$1.97 | \$1.77 | \$2.47 | \$1.27 |
| Capsicum | 1kg | \$6.21 | \$9.88 | -\$3.67 | \$5.07 | \$1.14 |
| Tuna | 1kg | \$17.00 | \$17.00 | \$0.00 | \$16.00 | \$1.00 |
| Tomatoes | 1kg | \$5.40 | \$7.06 | -\$1.66 | \$4.90 | \$0.50 |
| Yams - early | 1kg | \$5.79 | \$5.98 | -\$0.19 | \$5.33 | \$0.46 |
| Stringed fish (mixed) | 1kg | \$9.32 | \$9.65 | -\$0.33 | \$9.00 | \$0.32 |
| Sausages | 1kg | \$8.26 | \$8.26 | \$0.00 | \$8.23 | \$0.03 |

The annual headline inflation was at 1.2% for December 2019 compared to 0.1% in November 2019 and 4.8% for December 2018. This resulted from the increase in both imported and domestic prices over the year. Imported inflation rose by 2.1% over the year, contributing 1.1% towards the annual headline inflation. This increase is attributed to the increase in prices for imported food, alcoholic beverages, and transportation. Higher imported food prices for chicken pieces, apples, and mutton flaps drove the rising prices. Domestic prices also increased slightly by 0.1% over the year stemming from higher prices for house maintenance services, catering services, and water supply.

Competitive exchange rates

Table 3: Effective Exchange Rates

| | Dec-19 | Monthly | | Annual | |
|---------------------------------------|--------|---------|----------|--------|----------|
| | | Nov-19 | % Growth | Dec-18 | % Growth |
| Nominal Effective Exchange Rate Index | 91.5 | 92.1 | -0.7 | 91.7 | -0.2 |
| Real Effective Exchange Rate Index | 107.1 | 107.6 | -0.5 | 108.0 | -0.8 |

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) index fell over the month due to the appreciation of the AUD, NZD,

& FJD against the TOP. The Real Effective Exchange Rate (REER) index also declined reflecting the low level of inflation over the month. Over the year, both the NEER and REER decreased, reflecting Tonga's lower headline inflation rate relative to its trading partners.

Table 4: Bilateral Exchange Rates

| | Dec-19 | Nov-19 | Dec-18 |
|---------|---------|---------|---------|
| USD/TOP | 0.4349 | 0.4316 | 0.4436 |
| AUD/TOP | 0.6309 | 0.6302 | 0.6154 |
| NZD/TOP | 0.6596 | 0.6740 | 0.6480 |
| FJD/TOP | 0.8939 | 0.8911 | 0.8997 |
| JPY/TOP | 47.3495 | 46.8948 | 49.8480 |
| GBP/TOP | 0.3307 | 0.3339 | 0.3493 |
| EUR/TOP | 0.3905 | 0.3896 | 0.3894 |
| CNY/TOP | 2.8293 | 2.8082 | 2.8857 |

Source: Banking Systems

Higher OET payments in December 2019

Table 5: Foreign Reserves

| | Dec-19 | Monthly Nov-19 | % Growth | Annual Dec-18 | % Growth |
|----------------------------------|--------|----------------|----------|---------------|----------|
| Foreign Reserves (\$ in million) | 487.4 | 489.5 | -0.4 | 478.5 | 1.9 |
| Import Coverage (months) | 7.8 | 7.8 | | 8.4 | |

Source: National Reserve Bank Tonga

Higher payments for imports and services over the month of December 2019 lowered the official foreign reserves to \$487.4 million, equivalent to 7.8 months of imports. However, the foreign reserves rose by \$8.9 million over the year as a result of higher receipts from budget support, grants, and project funds from development partners.

Table 6: Overseas Exchange Transactions
Overseas Exchange Transactions

| | Monthly | | | Annual | | |
|-------------------|---------|--------|----------|--------|--------|----------|
| | Dec-19 | Nov-19 | % Growth | Dec-19 | Dec-18 | % Growth |
| Overall Balance | -2.1 | 0.2 | -1250.9 | 8.9 | 56.0 | -84.0 |
| Current Account | -2.1 | -1.0 | -112.8 | -19.3 | 28.2 | -168.4 |
| Merchandise Trade | -32.5 | -31.2 | -4.3 | -407.9 | -413.5 | 1.4 |
| Services | 0.2 | 3.6 | -94.7 | 24.0 | 29.5 | -18.5 |
| Income | 1.6 | 1.6 | -2.8 | 4.7 | 5.6 | -15.4 |
| Transfers | 28.7 | 25.0 | 14.8 | 359.8 | 406.7 | -11.5 |
| Capital Account | 3.1 | 1.9 | 66.2 | 38.0 | 27.9 | 36.5 |
| Financial Account | -3.1 | -0.7 | -344.1 | -9.8 | -0.1 | -17443.6 |

Source: Banking Systems

The overall Overseas Exchange Transactions (OET) balance recorded a deficit of \$2.1 million due to higher outgoing payments relative to the rise in receipts during December 2019. The deficit in the current account widened as payments for imported goods and services, such as travel allowance and professional & management services rose. This had offset a rise in current account receipts, mainly from private transfers, specifically remittances received during the festive month of December 2019.

Additionally, the financial account deficit also widened from \$0.7 million in November 2019 to \$3.1 million in December 2019, driven by a rise in inter-bank payments and investments abroad. However, the capital account surplus rose underpinned by higher receipts for construction purposes, both official and individual.

In year ended terms, the overall OET balance surplus of \$8.9 million was attributed mainly to higher net capital receipts of \$38.0 million for construction purposes. This had offset the increased net current and financial payments mainly for offshore investment, private transfers, and services.

Broad money decreased

Table 7: Broad Money

| | Monthly | | | Annual | |
|-----------------------------|---------|--------|----------|--------|----------|
| | Dec-19 | Nov-19 | % Growth | Dec-18 | % Growth |
| Broad money (\$ in million) | 602.2 | 605.6 | -0.55 | 605.3 | -0.50 |
| Net Foreign Asset | 502.5 | 502.8 | -0.1 | 502.1 | 0.1 |
| Net Domestic Asset | 100.4 | 103.4 | -2.9 | 103.6 | -3.1 |

Source: Banking System, National Reserve Bank of Tonga

Broad money fell over the month and year to \$602.2 million, by \$3.3 million (0.6%) and \$3.0 million (0.5%) respectively. Both declines were mostly driven by lower net domestic assets mainly on lower government deposits over the month, and the higher capital account over the year. The decrease in net foreign assets over the month was due to oil and other import payments, but the increase over the year was due to higher receipts of budgetary support, grants, and project funds from donor partners.

Liquidity rose

Table 8: Reserve money

| | Monthly | | | Annual | |
|-------------------------------|---------|--------|----------|--------|----------|
| | Dec-19 | Nov-19 | % Growth | Dec-18 | % Growth |
| Reserve money (\$ in million) | 305.1 | 301.2 | 1.3 | 324.7 | -6.0 |

Source: Banking System, National Reserve Bank of Tonga

Liquidity in the banking system increased over the month by \$3.9 million (1.3%) to \$305.1 million, due mainly to higher currency circulated to cater for the Christmas and New Year festivities. Over the year, the higher withdrawals made by the commercial banks from the Reserve Bank's vault lowered the Exchange Settlement Account (ESA) and further drove the decline in liquidity by \$19.6 million (6.0%).

Slower credit growth

Table 9: Total Lending

| Lending | Monthly | | | Annual | |
|-------------------------------|---------|--------|----------|--------|----------|
| | Dec-19 | Nov-19 | % Growth | Dec-18 | % Growth |
| Total Lending (\$ in million) | 500.9 | 504.3 | -0.7 | 479.9 | 4.4 |
| Business lending | 239.0 | 243.4 | -1.8 | 219.4 | 8.9 |
| Household lending | 261.8 | 260.8 | 0.4 | 260.1 | 0.7 |
| Other lending | 0.1 | 0.2 | -43.4 | 0.4 | -77.8 |

Source: Banking System, National Reserve Bank of Tonga

At the end of December 2019, banks' total lending declined by \$3.5 million (0.7%) to \$500.9 million. This was led by lower business lending mostly to public enterprises. Additionally, lower loans issued to the manufacturing, tourism, and agricultural sectors also supported the monthly decline. On the other hand, household loans rose driven by higher housing loans.

Over the year, the banks' total lending increased as a result of higher business lending, mainly to public enterprises, professional & other services, agriculture, and tourism sectors. This was also supported by an increase in households' housing loans. The banks' total loans to deposit ratio decreased from 81.2% to 80.7% over the month, reflecting the decrease in loans relative to the decrease in deposits.

Interest rate spread narrowed

Table 10: Weighted Average Interest Rates

| Interest Rates | Dec-19 | Monthly | | Annual | |
|---|--------|---------|--------------|--------|--------------|
| | | Nov-19 | Growth (bps) | Dec-18 | Growth (bps) |
| Weighted Average Banks Deposit Rate (%) | 1.994 | 1.950 | 4.4 | 1.897 | 9.7 |
| Weighted Average Banks Lending Rate (%) | 8.019 | 8.011 | 0.8 | 8.122 | -10.4 |
| Weighted Average Interest Rate Spread (%) | 6.025 | 6.060 | -3.6 | 6.225 | -20.1 |

Source: Banking System, National Reserve Bank of Tonga

Over the month and year to December 2019, the weighted average interest rate spread narrowed by 3.6 basis points and 20.1 basis points, respectively to 6.03%. The monthly decline was a result of lower housing loan rates, coupled with an increase in demand and term deposit rates.

Over the year, weighted average lending rates declined while weighted average deposit rates rose. The decline in weighted average lending rates resulted mostly from lower rates offered to tourism, construction, and agricultural sectors. The increase in weighted average deposit rates was mostly driven by higher demand and saving deposit rates.

Outlook

Although there is an expected pick up in domestic economic activity in January, the Reserve Bank expects a general slowdown in domestic economic activity for the

medium term due to the impact of Cyclone Tino on the outer islands. The outbreak of the novel coronavirus globally is also expected to impact Tonga's tourism and trading sectors due to restrictions on international travel and trade. The Australian bushfires may also contribute negatively to the inflow of remittances.

On the outlook, foreign reserves is still expected to remain at comfortable levels and above the minimum of 3 months of import cover. The inflation forecast is expected to be below the Reserve Bank's reference rate of 5% but with gradual increases in import prices. Credit growth will continue to grow at a slower pace, underpinned by excess liquidity in the banking system.

In light of the above developments, the Reserve Bank maintains its accommodative monetary policy stance at this time to encourage the utilization of the excess liquidity in the banking system for further lending to support economic activities and growth. The Reserve Bank continues to be vigilant in closely monitoring developments in the domestic and global economies and stands ready to adjust its monetary policy setting to ensure financial and macroeconomic stability are maintained.