



# QUARTERLY ECONOMIC UPDATE (QEU) March 2019

*MINISTRY OF FINANCE GOVERNMENT OF TONGA*

## Notes

- a) The following definitions are used in the Quarterly Economic Update (QEU):
- 'Real' means adjusted for the effect of inflation.
  - Real Gross Domestic Products (GDP) and Nominal GDP are linked through a measure of the price level.
  - The fiscal year (FY) of the government ends on 30 June. FY before a calendar year denotes the year in which the fiscal year ends, e.g.; FY2017 ends on 30 June 2017.
  - Forecast period refers to 2018/19 – 2020/2021.
- b) Figures in the tables and text have been rounded. Discrepancies in tables between totals and sums of components are due to rounding.
- c) The following notations are used:
- nil
  - na not applicable (unless otherwise specified)
  - \$ refers to Tongan Pa'anga (TOP) (unless otherwise specified)
  - \$m millions of Pa'anga (TOP) (unless otherwise specified)
  - (e) estimates (unless otherwise specified)
  - (r) revised estimates (unless otherwise specified)
  - (p) projected (unless otherwise specified)
- d) The following acronyms referred to as:
- |      |                                    |
|------|------------------------------------|
| AUD  | Australian Dollars                 |
| CT   | Consumption Tax                    |
| GDP  | Gross Domestic Product             |
| EU   | European Union                     |
| IMF  | International Monetary Fund        |
| MDAs | Ministries, Departments & Agencies |
| MT   | Metric Tonnes                      |
| MTO  | Money Transfer Operators           |
| NRBT | National Reserve Bank of Tonga     |
| NZD  | New Zealand Dollars                |
| OET  | Overseas Exchange Transactions     |
| PAYE | Pay As You Earn                    |
| TASP | Tonga Agriculture Sector Plan      |
| USA  | United States of America           |
| USD  | United States' Dollars             |
| WEO  | World Economic Outlook             |

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## OVERVIEW

The IMF World Economic Outlook Update- January 2019 estimated the global growth for 2018 at 3.7 percent and projected 3.5 percent growth in 2019 and 3.6 percent in 2020, a 0.2 and 0.1 percentage below the initial forecast in October 2018. The revised growth for 2019 and 2020 resulted from negative effects of Tariff increases that was put into practice in the United States and China in early 2018. The December 2018 Pacific Economic Monitor Update forecast 3.7 percent growth in 2018 and 2019 respectively, a 0.2 percent lower than their earlier forecast. This largely reflects moderation of economic activity in advanced economies due to rapidly increase in trade conflicts. Given the closely linkage between Tonga and its major Trading Partners (USA, Australia and New Zealand), the level of growth in these countries will affect the economy in terms of demand for Tonga's export products as well as the likely impacts on remittances from our families and friends abroad.

Growth projection for 2016/17, 2017/18 and 2018/19 is at an average rate of 2.7 percent. The outlook for the medium term is positive, supported by the continued recovery in agriculture, a more vibrant banking sector supported by growth-enhancing monetary policies of the NRBT, increasing trend of remittances from seasonal workers and increased foreign aid, boost in construction sector and the impacts on other subsectors, sound fiscal policies and development finance support to small scale industries. Despite all these things, Tonga is still recovering from TC Gita and everyone's effort are needed to address the issues of disaster risk management to ensure a resilient growth and a sustainable development in all sectors of the economy.

From government revenue and expenses, provisional data indicates a surplus of \$0.8 million at the end of the March quarter 2019 reflecting a sound fiscal control of government spending. Despite the lower collection of revenue and grants receipts of 55 percent during the review quarter, this was sufficient to cater for the total expenditure for the reviewed period. The decrease in both the total revenue and grants and total expenditure were expected due to lower economic activities during the concerned period compared to previous quarter. Outlook for the next quarter expects to improve due to the planned activities and events occur during the quarter including the Annual Church Conferences and the King's 60<sup>th</sup> birthday celebrations.

The level of foreign reserves at the end of March 2019 was \$465.0 million; equivalent to 7.7 months of import cover. The decline in foreign reserves during the quarter was attributed to lower receipts from remittances and foreign aid for various projects—level of foreign reserves was \$478.5 million in the previous quarter. The 7.7 months of import coverage for the review quarter continues to reflect the economy's comfortable external position that surpasses the minimum range target of 3 – 4 months set by the NRBT.

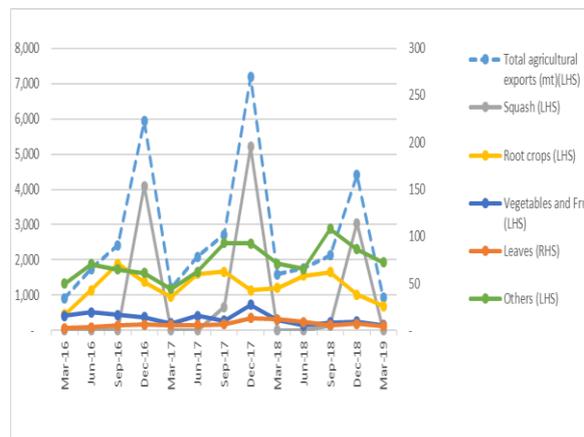
Tonga's vulnerability to weather conditions and climate change is one of the key risks in the medium term growth projections. Other factors include the uncertainties with the implementation of major construction projects—a scale down in the size, delay or cancellation of major construction projects could lead to a weaker growth over the forecast period. In addition, weaker than expected economic conditions in Tonga's main trading partners may pose a risk to Tonga's economy through lower remittances, tourist arrivals and travel receipts as well as lower demand for exports.

# REAL SECTOR

## PRIMARY

The Total Agricultural Exports for March 2019 quarter has decreased compared to both the previous quarter and the corresponding quarter of 2018. The decline from previous quarter is mostly attributed to the end of the squash pumpkin season. In addition to that, the Vegetables and Fruit, Root crops and Leaves all reduced by 65%, 46% and 40% respectively. The reduction on Vegetables & Fruits were from watermelon (33%) and brown coconut (79%) whereby the reduction on Root crops were mainly from Yams (97%) and Taro Tarua (50%). Leaves exports were reduced due to drop on Pele export– frozen cooked (40%). These reductions reflect the end of season for these crops. On yearly basis, the declined in the total Agricultural Exports are mainly from Leaves (138%) and Vegetables & Leaves (96%). We can all witnessed these reductions due to seasonality of Vegetables & Fruits as well as the Squash production.

**Figure 1: Agricultural Exports (mt) Quarterly**

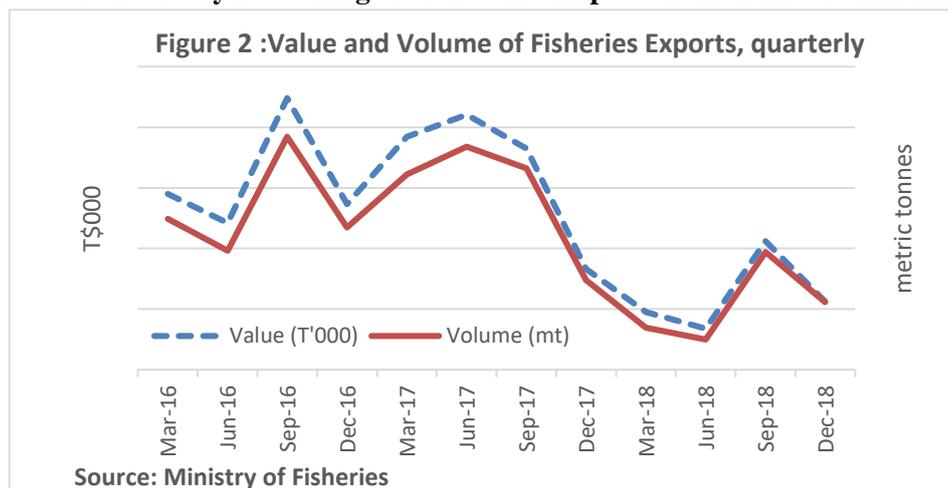


Sources: Quarantine Division, MAFF

There is a 2.5 percent growth projection in 2018/19 for Agriculture and anticipates to strengthen to an average of 3 percent in outer years.

For *Forestry* sub-sector: the ongoing activities such as re-planting and the continuous production of firewood and timber for domestic market is ongoing and expects positive growth over the forecast period.

**Fisheries sector are slowly recovering after TC Gita impact on the number of Fishing Vessels.**



Source: Ministry of Fisheries

The volumes of fish exports, comparing to the same period of last year, has dropped. Government is therefore reviewing its current policies in an attempt to revive the sector and to improve the total value of fish exports for March and June quarter and the overall growth of the Sector.

The outlook for the primary sector is positive attributed to the ongoing government projects and activities for recovery purposes in each sub-sector such as increasing participation in agricultural products – kava and vanilla due to their relatively high exports price.

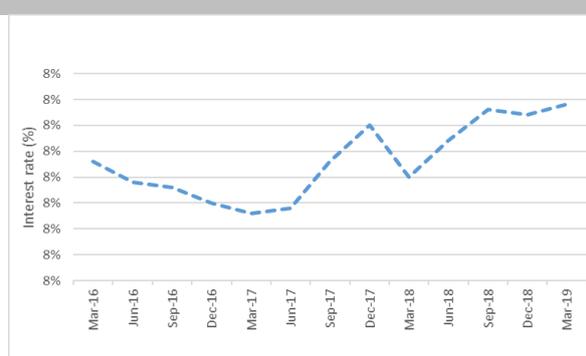
## SECONDARY

The growth prospects for secondary sector continued to be favorable due to the level of ongoing construction activities — both public and private. Most of these constructions were the rebuilt works followed TC Gita included school buildings, church buildings and individual housing. Other major reconstruction included the Tonga Transport Sector Consolidation Project, Tongatapu Village Network Upgrading Project and the renovation of Fua’amotu International airport.

In the near term, more construction activities expect to occur included the Tonga High School project, the re-location of Tonga Side School, the wind mill farming and others. The outlook for the construction sub-sector will be affected as observed interest rate for house lending continues to increase. This indicates high cost for constructions.

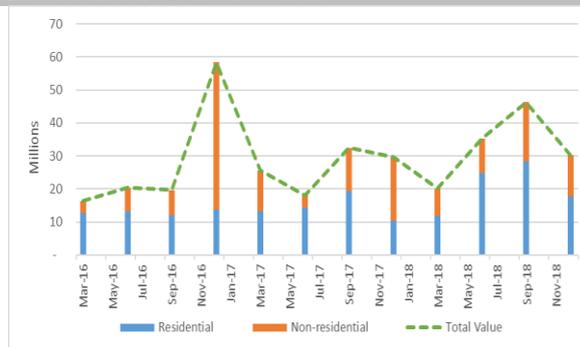
The projections for manufacturing, electricity and water supply sub sectors are to continue on their current growth in support of the continuing Tongatapu Village Network. The outlook for the Tourism Sector is positive in considering the increases in number of cruise ships docking at the Nuku’alofa Vuna ports, increase number of tourists whereby contributing to the growth projection for the secondary sector.

**Figure 3: House Lending rate %**



Source: National Reserve Bank of Tonga

**Figure 4: Value of Residential and Non Residential Construction**



Source: Ministry of Infrastructure & Tourism

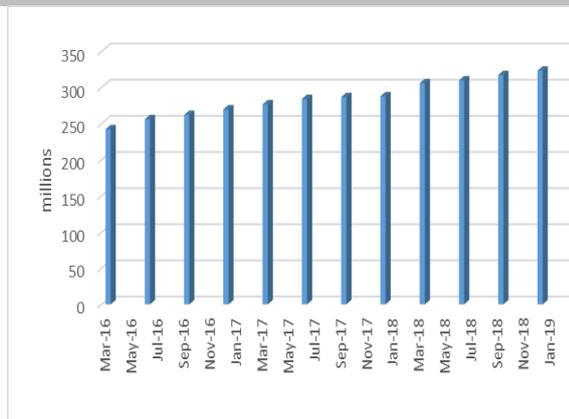
## TERTIARY

The growth in the Tertiary sector increased by 0.2 percent in 2016/17 to 3.6 percent in 2017/18 and down by 1.3 percent in compared to 2015/16. The outlook for 2018/19 and 2019/20 projects 4.1 and 4.2 percent growth respectively. The Tertiary Sector was active during the quarter as shown by the increased demand for transport services (both air and sea). This was reflected by the increased number of travelers to and from Tonga during Christmas and New Year holidays.

The Hotels and Restaurant, Wholesale and Retail reflected a slow growth as economic activity started to ease off as lots of families abroad returned after Christmas and new year’s season.

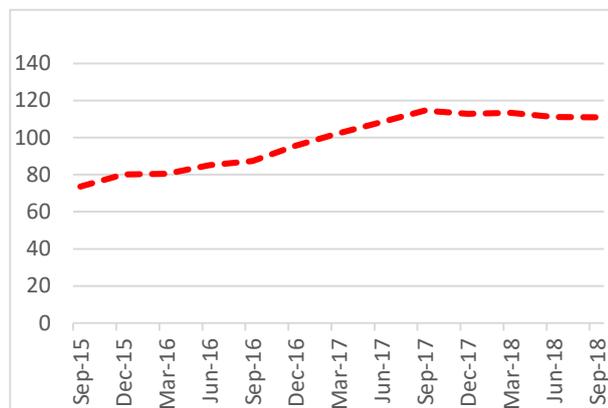
The outlook for tertiary sector is positive due to the continuous contribution from seasonal workers scheme and families abroad.

**Figure 5: Remittances, annual total (T\$)**



Sources: National Reserve Bank of Tonga

**Figure 6: Travel Receipts, Annual Total (T\$)**

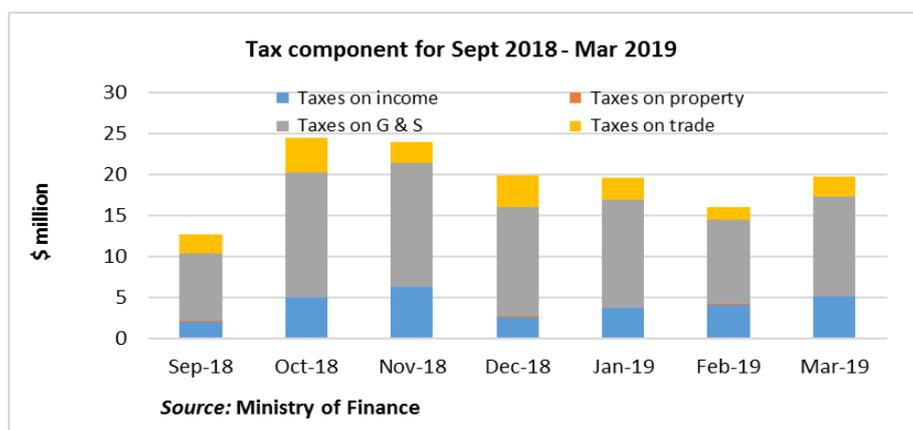


Sources: Statistics Department & Ministry of Finance

## FISCAL SECTOR

Total revenue and grants for the quarter fell by 26.8 percent in compared to the previous quarter mainly due to drop in revenue from International Trade & Transactions taxes by 54.8% for Import Duties from both Business and Government. Taxes on Goods and Services was also declined by 23.3 percent attributed to the declined revenue collected from Consumption Tax on Imported Goods and Services. The Income Tax and Tax on Property Income also dropped by 7.1% and 3.0% respectively. Grants from development partners also decreased for the same period.

**Figure 7: Tax Component for September 2018- March 2019**



The revenue collection from Excise tax alone decreased by 12% in compare to the last quarter. An additional of \$1 million was collected from foreign exchange levy to assist with the development of Sports and in the preparation for the South Pacific Games in Samoa.

The Domestic revenue from Tax collected since July to March 2019 was 72% of the overall Tax Revenue budgeted for the 2018/19.

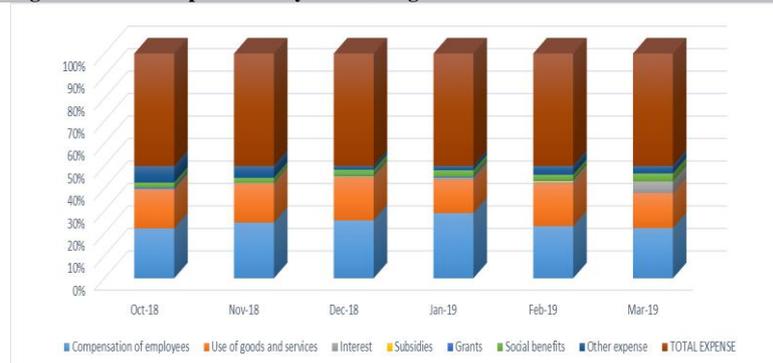
The total expenses for March quarter indicated a 3.5 percent decrease from the December 2018 quarter total expenses. The decrease in the quarterly trend reflected zero subsidies

paid in the month of February 2018. Grants for communities was also one of the main reasons for lower quarterly expenses. One additional factor for fall in expenses was the lower payment on the use of goods & services (11.1%) as well as the compensation of employees (by 1.8%).

The total expenses for the March quarter since July 2018 recorded at \$210.10 million which is the 64% (11% under-spend) of the overall expenditure for 2018/19.

The provisional figures for Gross Operating Balance (Revenue minus Expenditure) for March quarter recorded a deficit of \$4.6 million compared to a surplus of \$9.6 million in the December 2018 Quarter. A deficit of \$14.7 million was recorded in the first quarter of 2018/19. The deficit in the reviewed quarter was from the Total receipts from tax and grants of \$62.1 million compared to the total spending of \$66.7 million on the same period.

**Figure 8: Public Expenditure by Main Categories**



Source: Ministry of Finance

## ***EXTERNAL SECTOR***

As indicated from the provisional data, the expected earnings from export for March quarter were much lower for both the previous quarter and same quarter in 2018. This indicates the recovery from TC Gita for the Agricultural Products. The decrease in the Agricultural Sector were mainly from the export volume of squash pumpkin due to its seasonality and swamp taro leaves. The export volume for Root crops and Vegetables & Fruits were also decreased and it contributes to the overall decrease in the export earnings of the reviewed quarter. The latest figures for Fisheries sector- September 2018 indicates a decrease in the total Fisheries Exports and it was mainly from Tuna, Snapper and Shark meat.

On the outlook, Overseas Exchange Transactions Trade balance account for the next quarter expects to remain deficit due to more import payments despite the higher transfer balance. Remittances and other official Transfers are projected to increase in the next quarter due to the preparation for the Kings 60<sup>th</sup> birthday, the annual church conference, Tonga High School ex-students anniversary celebration, the Heilala Festival as well as Family Reunions and other functions in the community.

According to the latest quarterly data for import payments -September 2018, the price for diesel and fuel increased in line with the increase in global commodity prices. The demand for construction material were high due to recovery from TC Gita. The overall demand for goods and services increased attributes to the increase of import alcohol as many family and relatives travel to the Kingdom to attend the above mentioned events.

The level of Gross Foreign reserves that was recorded at the end of March 2019 was \$465 million or equivalent to 7.7 months of imports cover. That is \$13.5 million lower compared to previous quarter and \$17.3 million higher in compared to the same period in 2018.

Remittances in the reviewed quarter were recorded to be same with the previous quarter and higher by 17.7 million from the same quarter in 2018.

The 7.7 months of imports cover highlights that Tonga maintained a comfortable external position that exceeds the minimum range of 3-4 months set by NRBT.

**Figure 9: Gross Foreign Reserves vs Imports Cover**



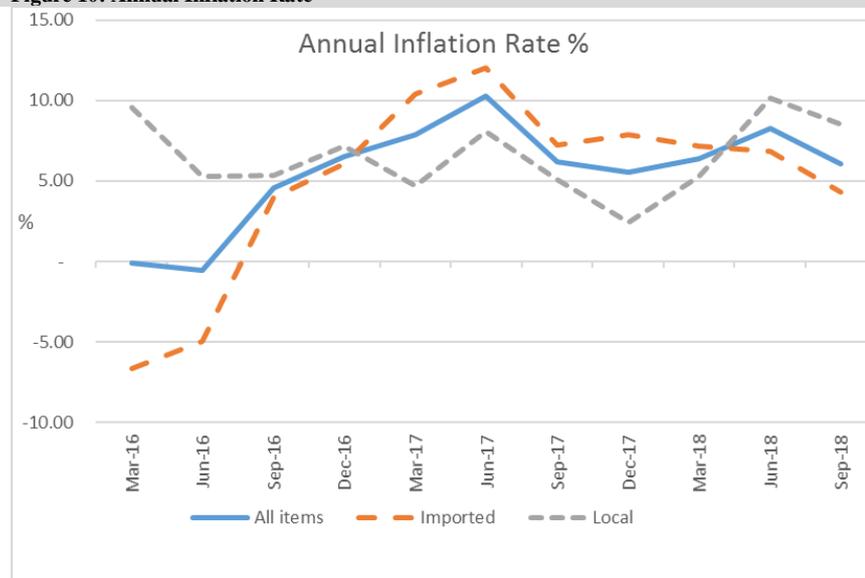
Source: National Reserve Bank of Tonga

## MONETARY AND FINANCIAL SECTOR

The available data for September 2018 quarter indicates an inflation rate of 6.08 percent compared to 8.30 percent in September, 2018 and 6.38 in March last year.

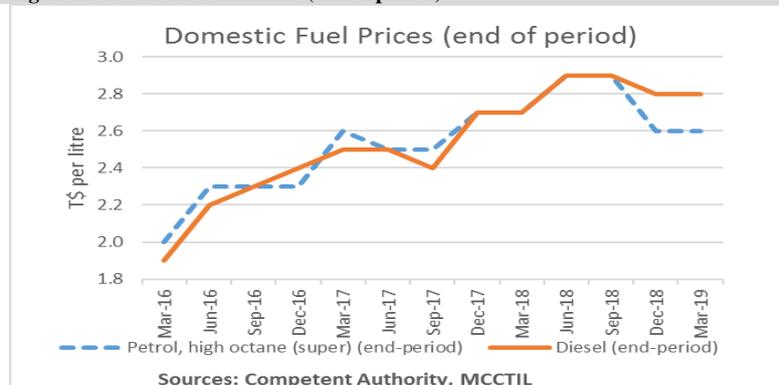
The graph shows the contribution of the prices of local goods and the imported goods on the overall inflation rate. Both local goods and imported goods decreases in the first quarter and imported goods increased in the second quarter while the local goods continue to fall. In the third quarter, the local goods increases while imported goods decreased and they both move as it is on the last quarter of 2017/18. On average the annual inflation rate for 2017/18 is 0.7 percent lower (6.61 percent) than the annual inflation rate for 2016/17 (7.31). This also reflect that people are now shifts from Imported Tobacco and Alcohol to Tongan Tobacco and Drugs and that is the main reason for the annual differences. The inflation rate for the reviewed quarter will

**Figure 10: Annual Inflation Rate**



Source: Tonga Statistics Department

**Figure 11: Domestic Fuel Prices (end of period)**



Sources: Competent Authority, MCCTIL  
Source: Competent Authority, Ministry of Labour, Commerce and Consumers

likely to be increased due to continued increases in the prices of local items such as Kava Tonga. One factor that causes the increases in inflation is the depreciation of the Tongan Pa'anga against other currencies and that contributes to increase imported inflation. The outlook for inflation in the medium-term is estimated to be higher than the average of 2017/18.

Price of fuel in the domestic market are pretty much the same throughout December 2018 and March 2019 quarter. In comparison with March 2018 quarter, Petrol price has decrease by 0.1 percent while Diesel price has increased by the same amount. On average, the annual domestic Fuel prices for 2017/18 for both Petrol and Diesel is 2.7 percent compared to 2.4 percent for both in 2016/17.

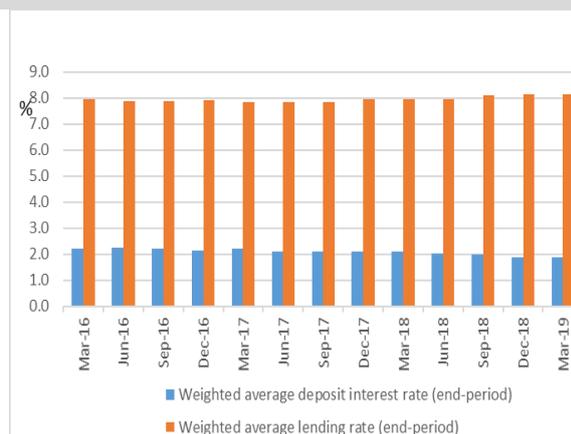
The changes in the quarterly Domestic Fuel Prices trend were due to the recent increases in global oil prices. The depreciation of the Tongan Pa'anga (TOP) and cost of freight services contributes to higher domestic Fuel Prices. The changes in the global market prices of Fuel were taking into account plus other factors that affected the domestic fuel prices.

The weighted average deposit interest rate at the end of March 2019 quarter is 1.9 compared to 2.1 percent March 2018. On quarterly basis, December 2018 quarter recorded the same with the reviewed quarter.

The weighted average lending rate for March 2019 recorded a 0.21 percent higher than March 2018.

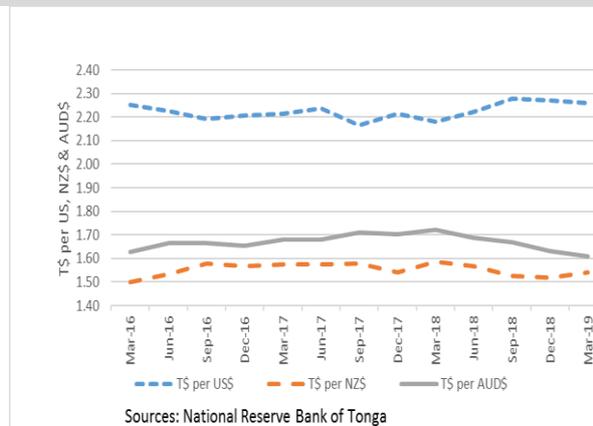
On period average for the end of March 2019, the exchange rate for US Dollar and Australian Dollar depreciates while NZ Dollar appreciates compared to previous quarter. Comparing to March 2018, US Dollar appreciates while the other two currencies depreciates. These movements were due to changes with major trading partners. The depreciation in the Tongan Pa'anga against the AUD and USD benefit the recipients of remittances in Tonga; while same is not the case for recipients of the NZ dollar.

**Figure 12: Interest Rate (%)**



Sources: OET, NRBT

**Figure 13: Exchange Rate (period average)**



Sources: National Reserve Bank of Tonga

Sources: OET, NRBT

## *RISKS*

Although we have a positive outlook for the quarter, many risks included the economy's high degree of vulnerability hindered development progress and growth projection.

The delay in the implementation of major construction projects led to revise down of growth during the forecast period. The major projects included the delay in the construction of Tonga High School Mini Sports Stadium and other projects.

Remittances is one of the major income of our people from our families and friends living abroad mainly in New Zealand, Australia and the United States of America. Tongan economy are highly dependent on the economic conditions of our major trading partners (Australia, New Zealand and the United States of America). The downtrend in these economies will lower remittances and the export receipts. The lower in remittances will also lower most household income and therefore reduced demand for goods and services. These will affect the overall economic GDP Growth.

## *CONCLUSION AND POLICY ISSUES*

To conclude, the global growth is very much affected by the activities undertaken in the most advance countries in the world such as UK and USA. That is a worldwide statement from the IMF to all its member countries. These include the spill-over effects of the United Kingdom's exit from the European Union, tighter credit conditions, exchange rate fluctuations, and the recovery of prices in global commodity markets.

To maintain the growth momentum for Tonga, the strengthening of fiscal and monetary policies, timely and efficient monitoring and evaluating to ensure effective implementation of government projects and activities, the monitoring of the Medium Term Expenditure Framework and the Debt Strategy are crucial to maintain macroeconomic stability. As such, the collaboration of all stakeholders is needed.

In addition to that, we urged the importance of better utilization of both government funds and development assistance to areas that will bring economic returns.

These include the ongoing efforts to support and enhance SME's development, through micro credit union and increase productivity within the public service.

Lastly, a sound policy to promote technical and vocational training and education as well as improved productivity of seasonal workers would help broaden economic opportunities.