



QUARTERLY ECONOMIC UPDATE (QEU) September 2017

(November 2017)

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 GDP deflator has been used as the relevant price level and inflation measure for our forecasts.
 - 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., FY2018 ends on 30 June 2018.
 - Forecast period refers to 2016/17 – 2019/20.
 - The information presented in this QEU is based on the latest available data as at the end of September 2017 on selected economic indicators. The indicators presented are those for which there are sufficient data and available frequently to provide an overview at the national, regional and global level.
- 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)
 - (f) or (e) forecasts or 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 |
| IMF | International Monetary Fund |
| mt | Metric Tonnes |
| NRBT | National Reserve Bank of Tonga |
| NZD | New Zealand Dollars |
| OET | Overseas Exchange Transactions |
| PAYE | Pay As You Earn |
| TSDF II | Tonga Strategic Development Framework 2015-2025 |
| USA | United States of America |
| WEO | World Economic Outlook |

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OVERVIEW

Over the reviewed quarter - September 2017, most of the economic indicators in Tonga's economy showed positive trends in lining with the positive developments in the global (IMF-WEO July 2017 update) and regional economies (ADB Outlook-Pacific Economic Monitor-PEM July 2017). Growth in the global economy is projected to pick up to 3.5 percent in 2017, from 3.2 percent in 2016, and then slightly increase to 3.6 percent in 2018. This reflected a recovery in the advanced economies especially in the U.S and a sustained pickup in the economic activity in the emerging and developing economies. U.S and China have tend to implement sound fiscal policies and good macroeconomic implications of such changes and policy assumptions as well as an upward revision of growth in Japan and subdued inflation rate in the advanced economies. Oil supplies have also pickup lately and so as prices at the same time. Similarly, price prospects in the Pacific region move along with the global development with a prospects of a quick recovery in Australia and a solid economic outlook for New Zealand (ADB Outlook through its Pacific Economic Monitor-PEM July 2017). The improvements in these economies continue to support growth in remittances to Tonga; increase in tourist receipts, increases in the number of people participating in seasonal workers schemes, as well as an increase in demand for Tonga's exports and support economic activities in Tonga.

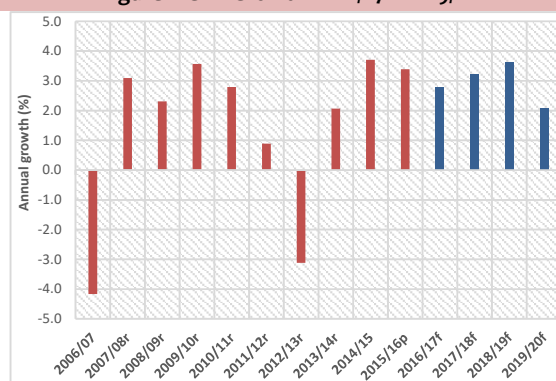
The average growth rate for Tonga over the forecast period is around 3 percent. This includes a 2.8 percent growth projected for 2016/17, around 3.2 percent for 2017/18, 3.6 percent in 2018/19 and then slow down to 2.1 percent at the end of the forecast period, 2019/20.

These positive outlook and moderate growth rates forecasted for Tongan economy are highly supported by strong performance in the construction activities, tourism through the events and high demand for services and agriculture sub-sector. Other supportive factors for these growth projections including the continued accommodative financial policy and cheaper lending rates, the strong growth in the number of seasonal workers and remittances, higher level of foreign reserves and import coverage, improving market access, diversify agricultural product exports, collective efforts in monitoring of public administration and services.

The annual inflation rate for September 2017 was 5.8 percent, which is slightly higher than the NRBT's inflation reference rate of 5 percent however lower compared to both the 7.0 percent in the same period a year ago and 10.7 percent at the end of the previous quarter. On quarterly trend, the decrease to 5.8 percent was due mainly to the decrease prices for both the imported and local components mainly on food, household operations products, transportation and tobacco, alcohol & kava. On annual trend, the decrease to 5.8 percent was driven by the decrease in prices of the local components mainly in food - fruits & vegetables - and clothing & footwear, despite the increase in prices for imported components and kava products. On the outlook, inflation is anticipated to stay around 5 percent on average in 2017/18 and to decline further in the medium-term.

The overall balance of risks remains tilted to the downside. Risks from a weaker growth in the global and regional economies – our main trading partners in particular (USA, Australia and New Zealand) could negatively impact Tonga via reduced remittances, grants from development partners, tourism and demand for exports. Pressures on correspondent banking relationships (CBR) may also weigh on Tonga's outlook by increasing the costs of remittances. Perhaps cost of production may increase, drive up inflation and household real income reduce due to a sharp increase in the global commodity prices that are currently

Figure 1: GDP Growth 2006/07 – 2019/20



Source:

■ actual from Stats Dept
 ■ Ministry of Finance projections (forecast period)

assumed to be fairly stable and to rise only gradually thereafter over the forecast period. On the domestic front, the increasing credit growth could threaten our financial stability as well as higher liquidity in the banking sectors if there would be a weak control and monitor. Wage bill under the government's ministries hold a bigger portion of government budget which could pose a higher risk to budget balance and also to debt sustainability if less supervision given. A potentially large burden to both fiscal expenditure and positive growth outlook for Tonga's economy could stem from unforeseen costs due to higher level of vulnerability to changes in weather conditions and natural disasters and degree of uncertainty in the size and timing of development funded construction projects, especially if donor intervention falls short. In addition, related political risk could also slow down the growth momentum. Fiscal position is expected to improve in the medium term with fiscal policy that continued to aim at addressing fiscal risks and building buffers along with good debt management to maintain fiscal sustainability. In addition, to secure fiscal space for growth-enhancing related spending in the medium term.

Budget performance against fiscal anchors over the reviewed quarter are at the level that still needs more efforts and to be well monitored mainly on the expenditure side. Provisional data indicated that the total revenue and grants were lower at the end of September quarter 2017 compared to the same period a year ago, due to lower collection from the domestic revenue and grants received during the reviewed quarter. The decrease in the domestic revenue was due to lower collection from taxes on international trade and transactions mainly from business import duties, taxes on property, and all categories under the non-tax items. The decrease in the level of grants received over the reviewed quarter is partially related to political matters especially with the dissolution of the Parliament during the last month of the reviewed quarter and re-election of members a year earlier than the normal round of election. However, it is noted the receipts of \$4.7 million as budget support from the European Union in August 2017. At the same time, the total collection from tax items higher compared to the same quarter a year ago. Domestic revenue collected at the end of September 2017 contributes about 17.5 percent to the original budget estimates for 2017/18.

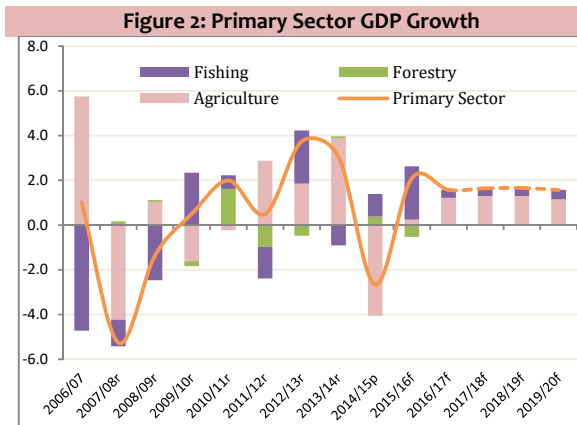
Provisional figures indicated that the level of government spending over the September quarter 2017 was 12.7 percent lowered compared to the same quarter in 2016. In addition to the government's efforts to scrutiny and closely monitor its expenditure, the political moves during the reviewed quarter giving the authority as caretaker for the current administration/ Cabinet, hence, no new and major budget implications decision to be made until the next administration resume in office, was also contributed to lower its spending over the concerned period. Seasonally, the pattern of government expenses in the September quarter is normally lowered – as the beginning of the new financial year – while the June quarter is usually the highest period of spending as it is the last quarter of the financial year and all payments should be done prior end of the fiscal year. The total expense for September quarter 2017 contributes about 12 percent to the original budget estimates for 2017/18.

Foreign reserves continued to remain at a comfortable level supported by strong donor inflows and high remittances. At the end of September 2017, it reached \$403 million and 6.8 months of import cover as per trade estimate and at 9.7 months of import cover as per OET estimate at the end of September 2017. This import coverage remains above the National Reserve Bank of Tonga's minimum range of 3-4 months of import cover which signifies that the country is in a comfortable external position.

REAL SECTOR

PRIMARY

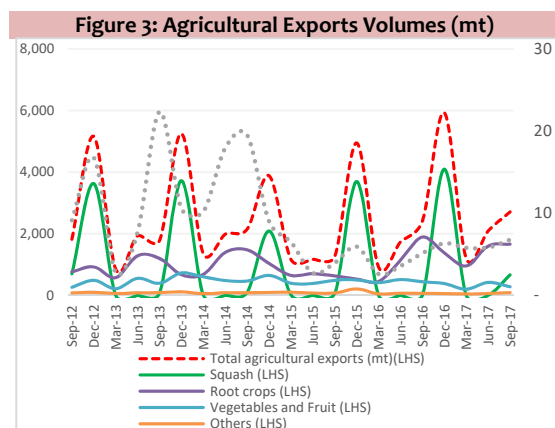
Over the September quarter 2017, provisional data showed a mixed results for agriculture and fisheries sectors. The good performance in the agriculture sector was supported by favourable weather conditions. This is clearly reflected in the increase in volume of the total agricultural exports and especially that the harvest season for squash pumpkin started during the reviewed quarter. Total agricultural exports for September quarter 2017 increased by 29.6 percent compared to the previous quarter and by 12.2 percent compared to the same period in 2016. The increase was due to the increase in the volume exported from pele leaves, squash pumpkin, giant taro, sweet yam, green coconut and dried kava chips and roots and herbal leaves and medicine.



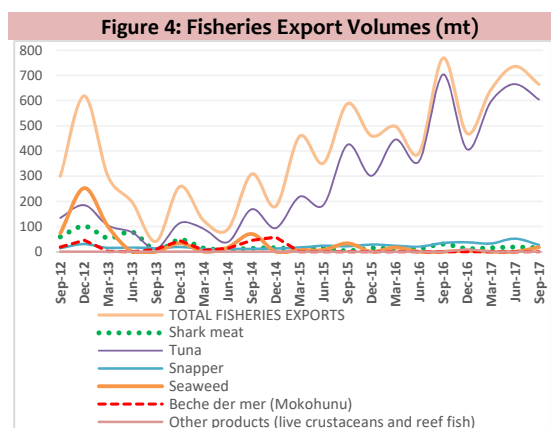
Sources: Statistics Department and Ministry of Finance

There is also an observed increase in the domestic production as domestic market was flooded with, other than root crops, vegetables and fruits including watermelons and pineapples.

On the other hand, volume for fisheries exports decreased by 9.7 percent compared to the previous quarter and by 13.6 percent compared to corresponding period last year. The decrease was attributed to the decrease in the export of tuna, snapper, shark and invertebrates. However, some other aquarium exports were increased included the live hard coral, live fish, shellfish and soft corals.



Source: Quarantine Division, Ministry of Agriculture, Food and Forestry



Source: Ministry of Fisheries

Modest level of production in the Forestry sector as reflected in the active trade of firewood and related timber and wood/ handicraft products in the domestic market. In addition, the electric poles are continued to transport over from ‘Eua to Tongatapu and treated for domestic use. There is also potential for export in the near future however, there are also number of arrangement and management issues to sort out first prior export.

Outlook for primary sector is anticipated to continue to grow at positive trend of around 2 percent on average from 2016/17 through to the end of the forecast period. The positive outlook is continued to be supported from the effects of Agricultural Market Fund and Fisheries Development and Export Fund through enhanced activities, various initiatives for improvement in the market access, improving access to the Agricultural Marketing Fund, improving procedures and quarantine issues for the export pathways in the

subsectors, on-going and new development projects highlighted in the sector plans for each of the subsectors. In addition, positive growth for the overall sector is also supported by the replanting initiatives for sandalwood and others, which aimed to improve performance of the forestry sub-sector.

SECONDARY

Indicators for activities in the secondary sector over the September 2017 quarter were mixed. On-going construction activities continued to boost performance in the sector, which is consistent with continuous growth in business lending for construction and individual housing loans. This indicates that the demand for services from quarrying, manufacturing – cement and building blocks - and electricity and water supply subsectors increase for construction activities. At the same time, cheaper lending rates for businesses' construction and individual housing loans also contributed for the positive growth projections for the sub-sector. In additions, the continuity of other construction related projects also assist to uphold the positive growth estimated for the sub-sector over the forecast period. These projects included the upgrading of the Fua domestic wharf, Tonga Transport Sector Consolidation Project, Ha'apai Reconstruction, Extension of the submarine cable to Vava'u and Ha'apai, and the Tonga Village Network Upgrading Project and others.

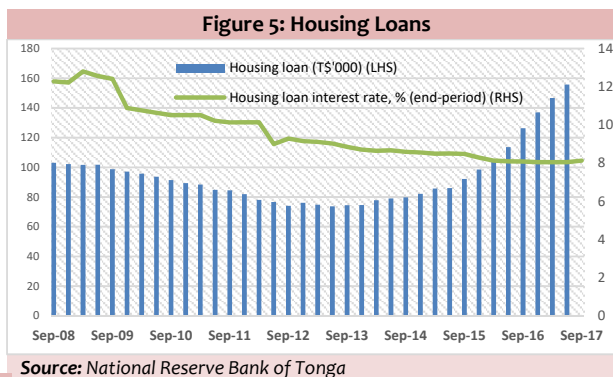
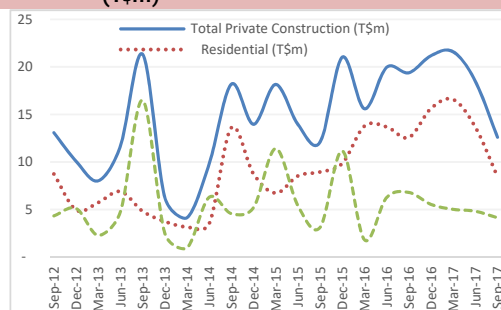


Figure 6: Private Residential and Non-Residential Building Construction, Value of Permits (T\$m)



However, over the reviewed quarter, the value of new building permits issued decrease for both private residential and non-residential construction while number of building permits issued continues to increase.

The import of construction materials continue to increase supported by the tax incentives for imported construction materials aimed to assist people of Tonga and to promote construction activities.

However, it is also noted that delay in the commencement of the public construction, for projects, push back the completion date and so as the strong growth anticipated in the near terms. This will provide a further boost for construction activity through the outer years of the forecast period. However, there are proposed projects that are yet to confirm its funding source, hence, a significant negative outturn in growth is anticipated due to completion of the confirmed and ongoing projects as experienced in 2012/13 - completion of these construction activities including the reconstruction of Nuku'alofa project.

On the other hand, production and trade of handicrafts were on the rise coincided with the increase in the number of cruise ship arrived into the kingdom during the reviewed quarter.

On the outlook, potential for positive growth for the secondary sector remains supported by the on-going construction activities, donor-funded construction projects including sport development related construction projects, tax incentives for imported construction materials, favourable lending rates for both businesses construction and individual housing loans and its effects on other sub-sectors, increasing number of tourist and cruise ships arrivals and handicraft products. In addition, the consumption tax (CT) returns from manufacturing businesses is anticipated to continue to increase supported by the promotion and award for businesses as set by the Ministry of Revenue and Customs.

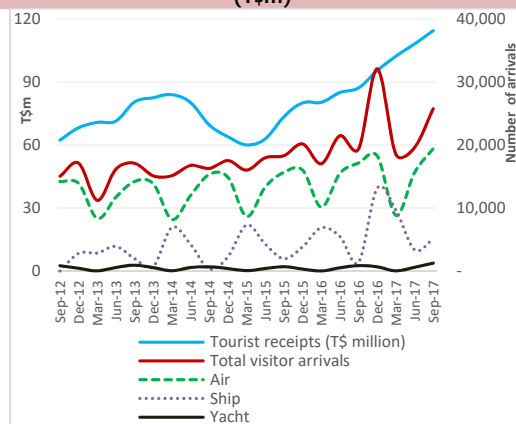
TERTIARY

Activities in the tertiary sector were fueled with the increasing trend in the number of tourist arrivals and travel receipts, continuous rising in remittances, increase in the number of containers and import of goods and so as wholesale and retail trade sub-sector, inter-island sea transport has also been strengthened as well as favourable banking environment for businesses.

The increase in the international arrivals and travel receipts were associated with the number of regional meetings held in Tonga during the reviewed quarter, as well as family reunions and also the welcoming of the Mate Ma'a Tonga team and officials at the end of the September quarter in additions to the annual events - heilala festivals and the celebration of HM's birthday.

The events mentioned above also created higher demand for trade services as reflected in the increasing imports of goods and services and distribution of goods through wholesale and retail trade services not only in the Tongatapu but also to Vava'u and rest of the outer-islands.

Figure 7: Tourist arrivals ('000) & travel receipts (T\$m)



Sources: Statistics Department & Ministry of Finance

Figure 8: Remittances – quarterly total (T\$m)



Sources: Statistics Department & Ministry of Finance

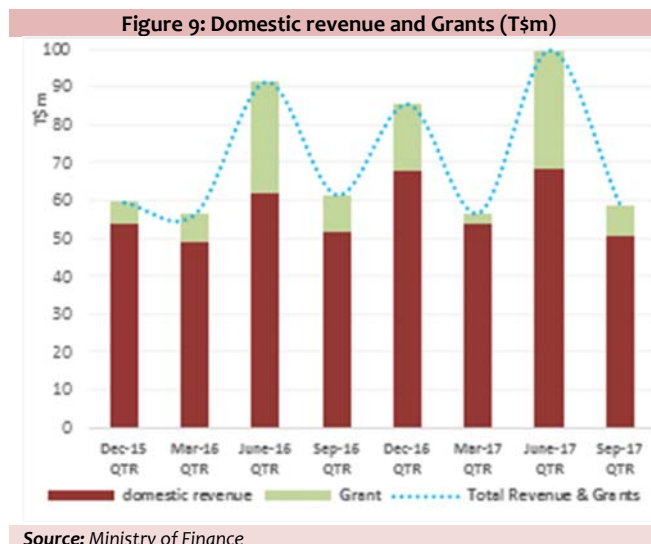
Demand and activities were fueled with the increasing receipts from remittances and further strengthened by the increasing number of vehicle registered and the coming into the market of the M. V. Maui for distribution of goods and services to the outer-islands. Figure 8 illustrated the pattern for remittances receipts on quarterly basis. It showed the high and low season for receiving remittances. It indicated that the reviewed quarter – Sept – is at the increasing point to the highest season. Receipts at the end of the reviewed quarter was totaled to around T\$80 million, an increase by 4.3 percent compared to June 2017 quarter and by 14.3

percent compared to Sept quarter in 2016. The increasing trend continues to highlight the significant role play by remittances to our economy and reflects the traditional values and closeness of 'nofo-'a-kainga'; continuing relevance of our traditional and family events. In addition, this also reflects continuing good relationship with Tongans in diaspora.

On the outlook, positive and modest growth is anticipated for the services sector in the outer years supported by the supported by spill-over effects to other sectors of a continued sound monetary policy and fiscal policy. This included a continued favourable banking environment with cheaper lending rates and an increasing deposit rates which will continue to boost businesses and individual loans and economic activities. A more conducive environment for doing business not only for tourism but also for foreign investors as well as well monitor and evaluating of working policy and conditions not only the agent but also the participant in the seasonal working schemes. Prudent fiscal policy had been undertaken to monitor higher wage bill through strict and carefully assessing of all public servant's performance through the Performance Management System (PMS), which could have an impact on the public administration and services.

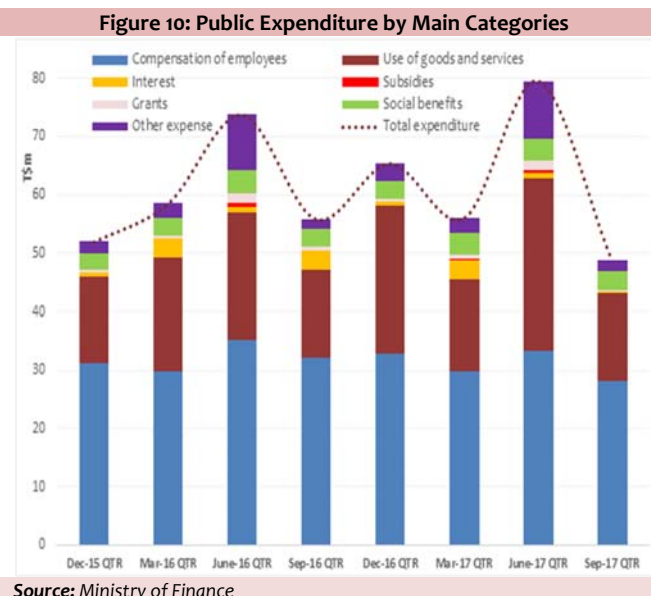
FISCAL SECTOR

Provisional data indicated that the total revenue and grants were lower by 4.5 percent at the end of September quarter 2017 compared to the same period a year ago, due to lower collection from the domestic revenue, by 1.7 percent, and grants received, by 19.5 percent, during the reviewed quarter. The decrease in the domestic revenue was due to lower collection from taxes on international trade and transactions by 15.3 percent mainly from business import duties, taxes on property by 3.7 percent, and all categories under the non-tax items by 31 percent. The decrease in the level of grants received over the reviewed quarter is partially related to political matters especially with the dissolution of the Parliament during the last month of the reviewed quarter and re-election of members a year earlier than the normal round of election. However, it is noted the receipts of \$4.7 million as budget support from the European Union in August 2017.



At the same time, the total collection from tax items were 2 percent higher compared to the same quarter a year ago. This increase was supported from the increase in collection of withholding tax from non-residents (by 119.7 percent), tax debts recovered from businesses' PAYE (by 28.1 percent) and CT (by over 500 percent), Excise tax (by 19.2 percent), revolving fund for motor vehicle (by over 12,000 percent), communication individual license (by over 400 percent) and others. Domestic revenue collected at the end of September 2017 contributes about 17.5 percent to the revised budget estimates for 2017/18.

Provisional figures indicated that the level of government spending over the September quarter 2017 was 12.7 percent lowered compared to the same quarter in 2016. The decrease in government spending was supported by the decrease in the compensation of employees (by 12.6 percent), interest payment (by 95.3 percent), grants (by 55.4 percent) and payment of social benefits (by 1.2 percent). In addition to the government's efforts to scrutiny and closely monitor its expenditure, the political moves during the reviewed quarter giving the authority as caretaker for the current administration/ Cabinet, hence, no new and major budget implications decision to be made until the next administration resume in office, was also contributed to lower its spending over the concerned period. The total expense for September quarter 2017 contributes about 12 percent to the revised budget estimates for 2017/18.



Seasonally, the pattern of government expenses in the September quarter is normally lowered – as the beginning of the new financial year – while the June quarter is usually the highest period of spending as it is the last quarter of the financial year and all payments should be done prior end of the fiscal year.

Figure 11: Fiscal Anchors

Fiscal Anchors	Target	Sept-16 Qtr	Dec-16 Qtr	Mar-17 Qtr	June-17 Qtr	2016/17 prov	Sept-17 Qtr	2017/18 est
Domestic revenue to GDP (%)	> 22%	5.4%	7.1%	5.7%	7.2%	25.4%	n.a.	28.8%
Compensation of employees (% of Domestic revenue)	> 53% of Domestic revenue	62.4%	48.4%	55.7%	48.9%	53.2%	55.5%	51.3%
Compensation of employees (% of operating expenditure)	> 45% of operating expenditure	57.8%	50.3%	53.3%	41.9%	50%	57.8%	36.5%
External debt to GDP (% of GDP)	< 50%	-	-	-	-	44.0%	-	42.7%

Source: Ministry of Finance with ADB/WB

The budget performance for the first quarter of 2017/18 according to the established fiscal anchors is still above the benchmark. The compensation of employees against domestic revenue is estimated at 55.5 percent against the target of 53 percent. The compensation of employees against operating expenditure is reported at 57.8 percent against the 45 percent target. This achievement is slightly above the target and likely to achieve in the medium term.

The Domestic revenue to GDP is still above the target which shows good sign from more economic activities happen in various sectors of the economy. The quarterly performance is not available as there are no quarterly GDP estimate to allow the calculation of the indicators. If all remains constant and in view of trying to picture the likely pattern on quarterly basis, indicative number indicates similar trend been reflected as it was in the same period a year ago.

The whole idea of these fiscal anchors are to make sure that there enough resources saved for other priority area that need Government funding. Sharing of resources is the key fundamentals of the whole budget process of the Government and there is a need to consider the resource allocation from a Macroeconomic perspective.

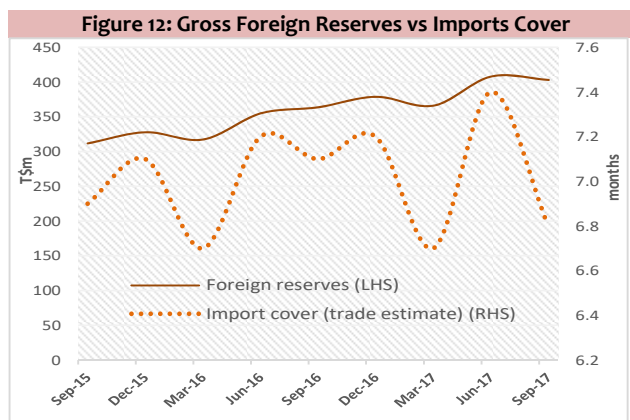
EXTERNAL SECTOR

At the end of the September quarter 2017, higher earnings from export is anticipated compared to the previous quarter and the corresponding period in 2016. The increase in receipts for both the quarter and annual trends is coincided with the increasing trend in the volume, in metric tonnes, for the agricultural exports by 29.6 percent and by 12.2 percent as shown by provisional data. Higher volume of squash pumpkin is anticipated to be exported in the next quarter, October 2017 in particular —peak month in the squash pumpkin season— compared to the reviewed quarter, implies higher export proceeds. On the other hand, lower receipts were expected from fisheries exports as per lower volume of fisheries products exported over the reviewed quarter compared to previous quarter and same period a year ago. The decrease in exported volume were mainly due to less volume exported from the main fisheries export product such as tuna and snapper as they are highly migratory species around this season.

On OET (Overseas Exchange Transactions) basis, the Trade balance account improved in the reviewed quarter compared to the previous quarter and same period in 2016 as the increase in exports was higher, by over 300 percent, than the increase, by only 27 percent, in imports.

The continued increase in remittances is well noted as well as the increase in other official transfers which were highly associated with development projected and the annual events that occurred in the reviewed period. This led to increase in the import payments driven by higher demand for goods and services related to the events during the review quarter. In the near term, outlook for the current account of the BOP is to continue to slowdown in deficit due to the favourable receipts from agricultural exports of squash pumpkin, at its peak season as well as more festivities and family obligations, which requires more remittances, during the Christmas holidays.

The level of foreign reserves remained accommodative at a higher level of \$403 million pa'anga at the end of September quarter 2017, higher by \$39.3 million than same period in 2016, however it was slightly lower by \$4.9 million compared to June quarter 2017. The higher level of foreign reserves indicates the continuous increase in public and private transfers which equivalent to 6.8 months of import cover as per trade estimates and at 9.7 months of import cover as per OET estimate at the end of September 2017. This import coverage remains above the National Reserve Bank of Tonga's minimum range of 3-4 months of import cover which signifies that the country is in a comfortable external position.



Source: NRB

MONETARY AND FINANCIAL SECTOR

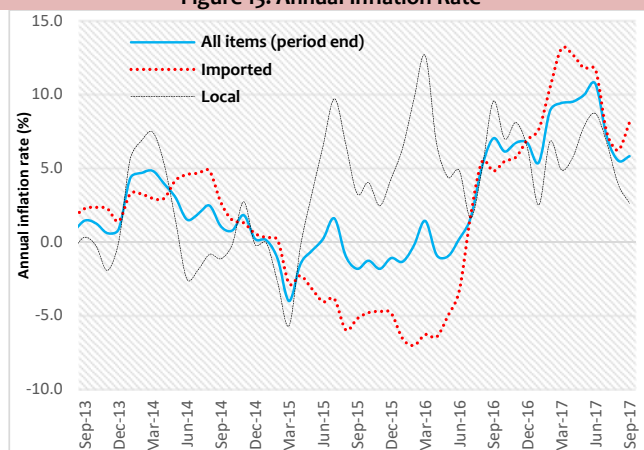
At the end of the reviewed quarter, both the weighted average deposit interest rates and the weighted average lending interest rates were lowered when compared to the corresponding period in 2016. This implies less incentive to save but a motivation to borrow money especially at a lower cost. This is reflected by the increase in the annual total outstanding loan of \$417 million with more cheaper weighted lending rate of 7.85 percent and the at the end of the review quarter compared to same period a year ago with only \$362.7 million at a slightly higher rate of 7.88 percent. In comparison to the previous quarter, interest rates were slightly higher by only point four percent for the weighted average deposit interest rates and point two percent for the weighted average lending interest rates. Overall, the cheaper lending rates motivate borrowing and spending of money, which boosts the economic activities, this also led to a slight increase in the inflation rate at the end of the reviewed period.

Annual rate of inflation for the year ended September 2017 was 5.8 percent, a significant decrease from 10.7 percent in June 2017 and 7.0 percent in the same period a year ago. On quarterly trend, the decrease to 5.8 percent was due mainly to the decrease prices for both the imported (from 11.7 percent in June to 8.1 percent) and local (from 8.7 percent in June to 2.6 percent) components mainly on food,

household operations products, transportation and tobacco, alcohol & kava. On annual trend, despite the increase in prices of the imported components and kava products, the decrease to 5.8 percent was driven by the decrease in prices of the local components (from 9.5 percent in September 2016 to 2.6 percent) mainly in kava, food - fruits & vegetables - and clothing & footwear. On the outlook, inflation is anticipated to stay around 5 percent on average in 2017/18 and to decline further in the medium-term.

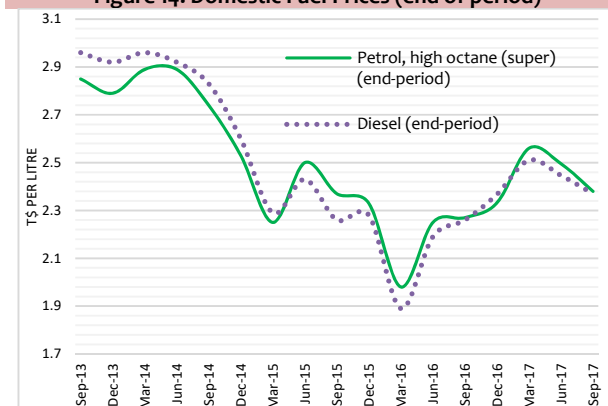
Domestic oil prices (both petrol and diesel) at the end of September quarter 2017 continued at its decreasing trend since March quarter 2017, however, it was still higher compared to same period a year ago. The decreasing trend is consistent with lower imported price for the Transportation and Household Operations components of the CPI at the end of the reviewed quarter compared to end of previous quarter. The increase on year-on-year basis, is associated with the increase in the global oil price index. This provides sign of continued strengthening of global activity, growth in global trade and industrial production in particular as it remained well above the previous year. This included the increase in oil supply in the United States, the increase in the refined petrol prices in Singapore together with the depreciation of the pa'anga against the US dollar and higher cost of freight.

Figure 13: Annual Inflation Rate



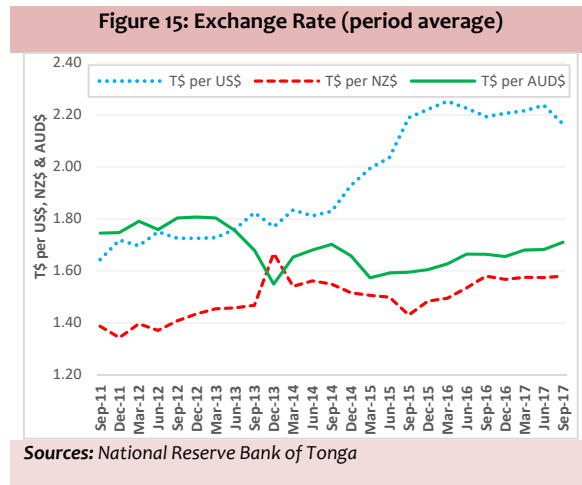
Source: Tonga Statistics Department

Figure 14: Domestic Fuel Prices (end of period)



Source: Competent Authority, Ministry of Commerce, Consumers, Trade, Innovation and Labour

The effect of higher inflation rate continued to reflect its impact Tonga’s exchange rates over the reviewed period, for instance, in Tongan Pa’anga (TOP) in relation to the currencies of our trading partners – AUD and NZD, except for USD. At the end of September 2017 quarter, on period average, Tongan Pa’anga depreciated against the New Zealand dollar and Australian dollar however, appreciated against the US dollar compared to previous quarter. This movement is due to changes in trading partners’ economies; falls in global commodity prices have affected the values of the NZD and AUD. Over the reviewed period, the USD has been depreciating as the economy is progressively weakens and an experience of a drop in the Fed rate. The Pa’anga continues to appreciate against the US Dollar from an average of T\$2.24/\$1 in June 2017 quarter to T\$2.16/\$1 at the end of September 2017 quarter. The depreciation in Pa’anga against the New Zealand and Australian dollars continued to benefit the recipients of remittances in Tonga. Despite the appreciation in Pa’anga against the US dollar, the recipients of US dollar over the September 2017 quarter are still far advantage than those recipients between September quarter 2009 and June quarter 2015 with an average of T\$1.83/\$1.



RISKS

There are a number of key risks, both from external and domestic sources to our economic forecasts hence, the overall balance of risks remains tilted to the downside.

Risks from a weaker growth in the global and regional economies as well in the economies of our main trading partners (USA, Australia and New Zealand in particular) could negatively impact Tonga's growth outlook via reduced remittances, grants from development partners, tourism and demand for exports. Pressures on correspondent banking relationships (CBR) and associated increased cost of remittances may also weigh on Tonga's outlook. Tongan economy, as a smallness and remoteness, is also heavily reliant on external income in the form of donor aid and remittances. Weaker growth and any uncertainties in the economic conditions in our main trading partners and main remitting countries - Australia, New Zealand and the USA - could pose a risk to our strong and positive growth projections, (ADB – Pacific Economic Monitor, July 2017), with lower level of remittances, tourist arrivals and demand for exports. Also there is possibility for an increase in cost of production, rise in the inflation rate and a decrease in the household real income due to a sharp increase in the global commodity prices that are currently assumed to be fairly and gradually upsurge over the forecast period.

On the domestic front, a potentially large burden to both fiscal expenditure and positive growth outlook for Tonga's economy could also stem from unforeseen weather conditions and natural disasters as well as the uncertainty that often surround the size and timing of donor funded construction projects. Natural disaster could pose a risk to all sectors in the economy. Primary sector, in particular, is extremely vulnerable to natural hazards, weather condition, for agriculture and fisheries sectors as well as other activities in other sectors. For the secondary sector, the risk to our forecast of strong growth could stem from a scale down in the size, delay or cancellation of major construction project(s). The result could lead to overall weaker growth through the forecast period.

There are also potential risks that could add-on if public sector employment reform fails to monitor wage growth especially on fiscal sustainability considering the commencement of external loan repayments. Wage bill under the government's ministries hold a bigger portion of government budget which could pose a higher risk to budget balance and also to debt sustainability if less supervision given. All these will lead to a slowdown in domestic activity and slower overall GDP growth.

Furthermore, potential risks in the financial market could stem from higher lending rates and high non-performing loans, although it is currently low. The increasing credit growth could threaten our financial stability as well as higher liquidity in the banking sectors if there would be a weak control and monitor.

In addition, risks from uncertain political environment could also slow down the growth momentum. The sudden dissolution of Parliament and the unexpected election been announced to hold a year earlier than the normal schedule tend to hold back some of Tonga's main development partners from their grants disbursement schedules until the election is completed.

CONCLUSION AND POLICY ISSUES

It is vital to put more efforts and focus on the key important contributors in maintaining of the current growth momentum for the country. These included a strong accommodative monetary policy, growth enhancing policy and stronger commitment to ensure fiscal prudence, renewed reform efforts and effective implementation of programmes, close monitoring of the TSDF II outcomes as well as the medium term expenditure framework and debt strategy. Additionally, as Tongan economy is heavily reliant on external income and so it is vulnerable to external shock, it is important preserve fiscal and external policy to cope with adverse shocks in the short term, while in the longer term there's greater need to boost public investment and reduce dependence on aid and remittances. It is also important to continue to sustain the level of budget support from development partners as to drive achievements of set targets for the economic

and social sectors, while more efforts from all stakeholders to become independence from donor community and reducing aid addiction is needed. At some point, the country would need to prepare for future disaster, other than building fiscal space, Tonga would need to maintain international reserve buffers. Current government efforts aimed at supporting SMEs, pursue structural reforms to improve the investment climate and diversifying the export basket and trading partners will also be important for improved future growth prospects. The short-term fiscal policy assumptions used in this Quarterly Economic Update (QEU) are normally based on fiscal anchors - set by government, World Bank (WB) and IMF staff - and officially approved government budget as well as macroeconomic assumptions and implications of the projected outturn. The medium-term fiscal projections are similarly based on a judgement about the most likely path of policies. Fiscal position is expected to improve in the medium term as government fiscal policy continues to address fiscal risks and build fiscal buffers. Furthermore, the maintenance of fiscal sustainability that at the same time assures a growth-enhancing spending remains the debt management stance of Government in the medium to longer term.