



**QUARTERLY ECONOMIC UPDATE  
(QEU) September 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 2018-2024.
- 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 global economy was projected to grow at 3.0 percent in 2019, a significant drop from the level in 2017-18 financial years for emerging market, developing economies and advanced economies and expected to recover to 3.4 percent in 2020. A slightly higher growth rate was projected for 2021-24 years. This global growth pattern reflects a major downturn, although estimated a projected recovery in some of the emerging market economies. By contrast, growth forecasts to moderate in years 2020 and beyond for some economies including the United States, Euro area, China, and Japan – account to half of global GDP. The growth in the Pacific sub-region reflected a recovery in 2019 from a disaster-related slowdown in 2018. The growth profile for the sub-region indicated a lower rate of 1 percent in 2018, compared to the initial estimate of 2.6 percent in 2017, a pick up to 3.5 percent in 2019 prior to slightly moderate at 3.2 percent in 2020. In particular, the reconstruction and rehabilitation efforts in Papua New Guinea, following last year's major earthquake, the economic recovery in Timor-Leste and the continued growth in other countries—including Tonga and Samoa.

The Tonga economy grew at 0.3 percent in 2017/18 and estimated growth of 2.6 percent in 2018/19. The impacts of Tropical Cyclone GITA in 2017/18 reflected on a reduction in agricultural production and other main sectors of the economy, caused delays in the implementation of major development projects. The 2018/19 growth factored in the improved performance in the agricultural and fisheries exports, electricity & water supplies, construction and the services sectors.

On the fiscal side, the Government revenue and expenses estimated a deficit of \$4.7 million at the end of the 2019 September quarter. The spike on quarterly expenses were triggered by the increased spending on the use of goods and services – basically on maintenance costs of building/compounds, roads and other expenses include payment of subsidies, grant for sports activities towards the Mate Ma'a Tonga team and 'Ikale Tahī Rugby team participated in Rugby World Cup 2019 competition. The lower collection of revenue was triggered by the slow collection in Income Tax, Corporate Tax both from large & small businesses and the declined collection of tax debts. The outlook for the next quarter expected improvement considering the Christmas and New Year season as well as many family reunions and other functions.

The foreign reserves by the end of September 2019 was \$490.8 million, equivalent to 7.9 months of import cover. This was around 1 percent higher, by \$6.5 million, compared to the previous quarter and about 9 percent or \$38.6 million higher than the recorded amount at the end of September 2018. The increase was mainly due to higher receipts from remittances and foreign aid during the review period. The 7.9 months of import coverage reflected Tonga's accommodative external position, surpasses the minimum range of 3 – 4 months set by the NRBT.

Tonga's vulnerability to weather conditions and climate change continued to be one of the key risks in the medium-term growth projections. Other factors include uncertainties in the implementation of construction projects— due to various reasons: scale down in the size of the project, delay or cancellation of major construction projects resulted in revised down of the growth projections over the forecast period. In addition, the impact on the economic conditions in Tonga's main trading partners had impacts on Tonga's economy through lower remittances, tourist arrivals and travel receipts as well as lower demand for exports.

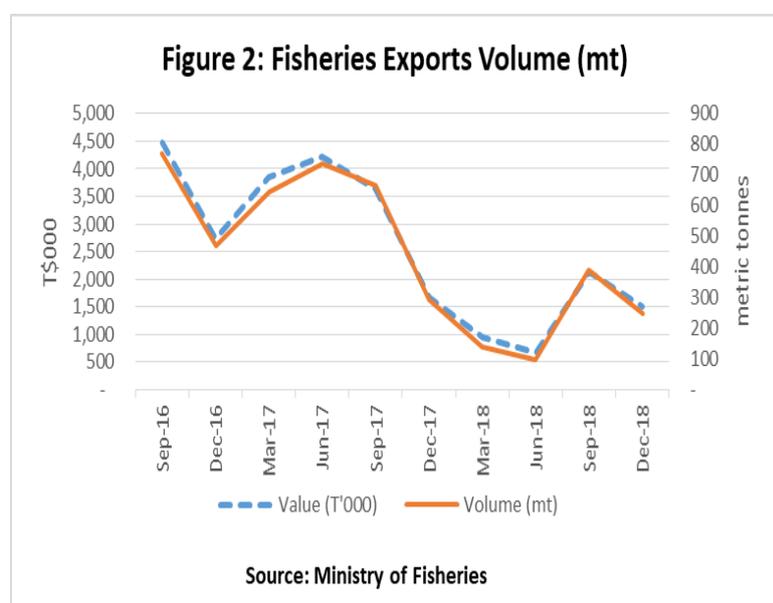
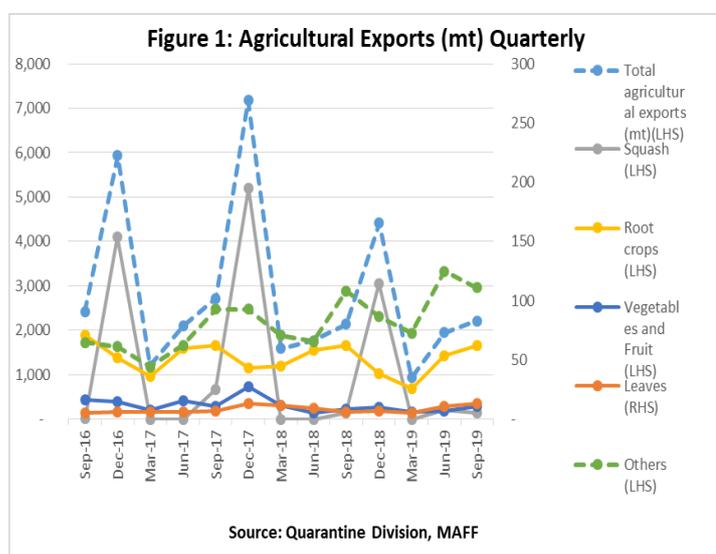
## REAL SECTOR

### PRIMARY

Positive growth was projected for the primary sector in 2018/19 assuming a recovery from drought effects in the agriculture sector in conjunction with continuous positive performance in the fisheries and forestry sub-sectors. Moderate growth is expected for the rest of the forecast period this is clearly reflected in the increase in volume of the total agricultural exports.

The provisional data from Quarantine indicates that the total volume of Agricultural exports for the September quarter 2019 increased by 14 percent compared to the previous quarter. The

increase was mainly from the export of taro leaves and root crops such as cassava, giant taro and yam not to mention the squash pumpkin harvest season in December 2019. On a year-on-year basis, total agricultural exports for the review period increased by 0.3 percent compared to the same period last year. This increase reflected the recovery activities from cyclone Gita together with rainfall on the previous quarter, outcome in increased supplies in taro leaves by 29 percent and vegetable and fruits by 61 percent. On the domestic market, it is projected to continue in the positive trend due to the harvesting and good weather season.



*Fisheries subsector:* the value of fisheries products decreased by 29 percent compared to the previous quarter, attributed to decrease in the export of tuna, live hard coral, snapper and shark meat. This is lower by 42 percent in compared to the corresponding period last year. The annual trend decline was attributed to the impacts by TC Gita to some of the fishing vessels and the total value of fisheries exports for September and December 2019 quarters.

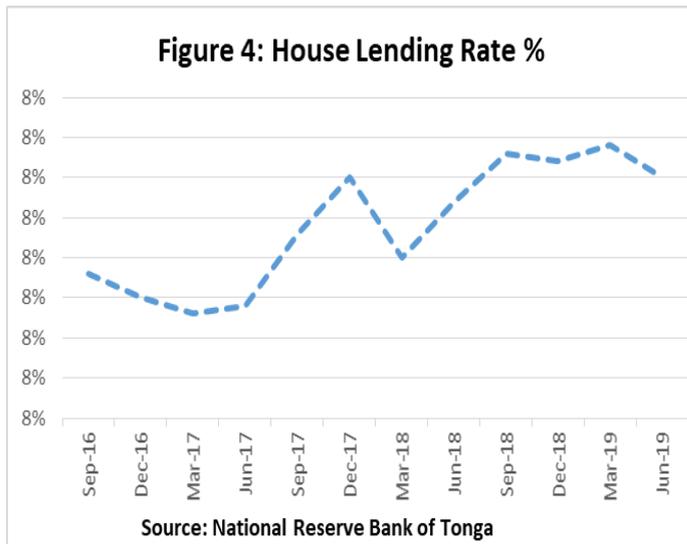
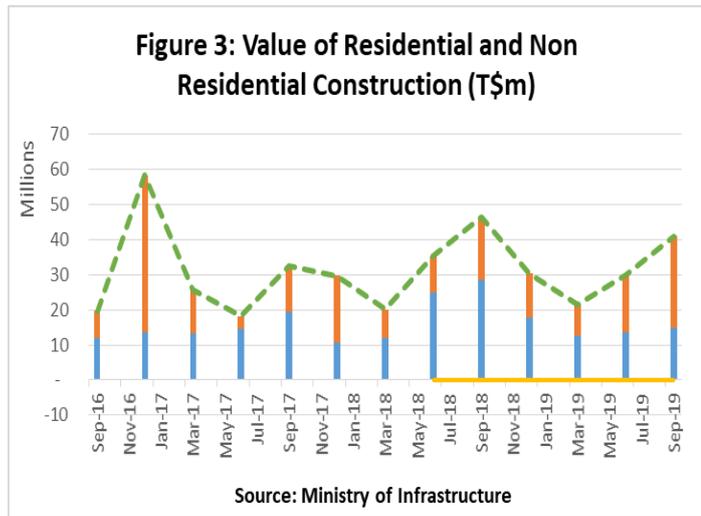
From the Forestry sector, ongoing activities include re-planting as

well as increase the production of firewood and timber for domestic market. In addition, 'Eua remains the major supplier for the electric poles and transport over to Tongatapu for domestic use.

The outlook for primary sector is positive, considered supported by the availability of Agricultural Market Fund and Fisheries Development facilities to help the development of the business sectors. In addition, the ongoing recovery and other development activities carry out under each of the sub-sectors include the works towards upgrading of rural and agricultural roads.

## SECONDARY

Over the reviewed period, ongoing construction works had been carried out in the secondary sector with the completion of various big projects. These include the construction of the Ha’apai new hospital building, Revenue and Customs main office, His Majesty’s Army Force’s building at Touliki and the upgrading of the Teufaiva stadium. The construction activities continued to boost performance in the sector, consistent with the continued growth in business lending for construction and individual housing loans. This was also reflected in the increased demand for quarrying, manufacturing – cement and building blocks - electricity and water supply sub-

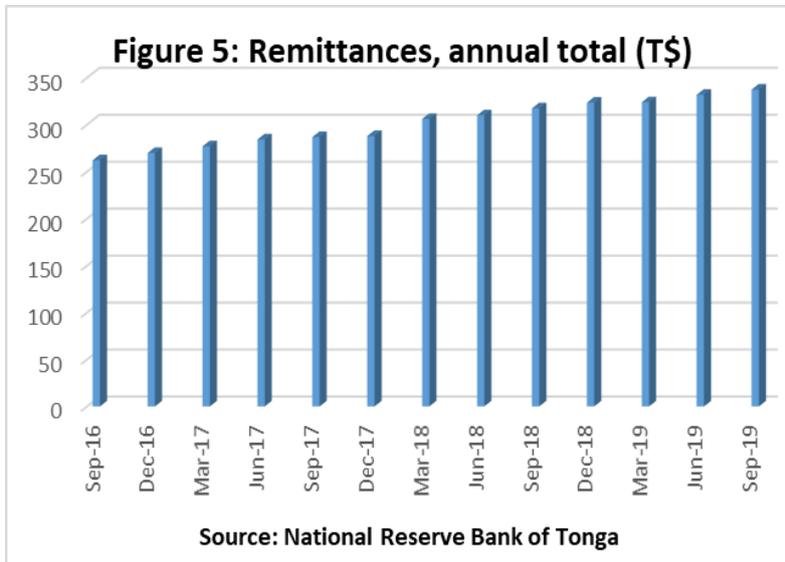


sectors. At the same time, Bank offered lower lending rates for business constructions and individual housing loans had also contributed to the positive growth projection for the sector. In addition, the continuity of other construction related projects had also assisted in maintaining a positive growth estimates for the sub-sector over the forecast period. These projects included the construction of the National Early Warning system, Installation of the Wind Generation System, Nuku’alofa Network Upgrade Project and TC Gita school and housing reconstruction.

The outlook remained positive for the secondary sector with the continuation of the construction activities, donor-funded construction projects including the sport development related construction projects, favorable lending rates for both businesses construction and individual housing loans and its positive effect on other sub-sectors.

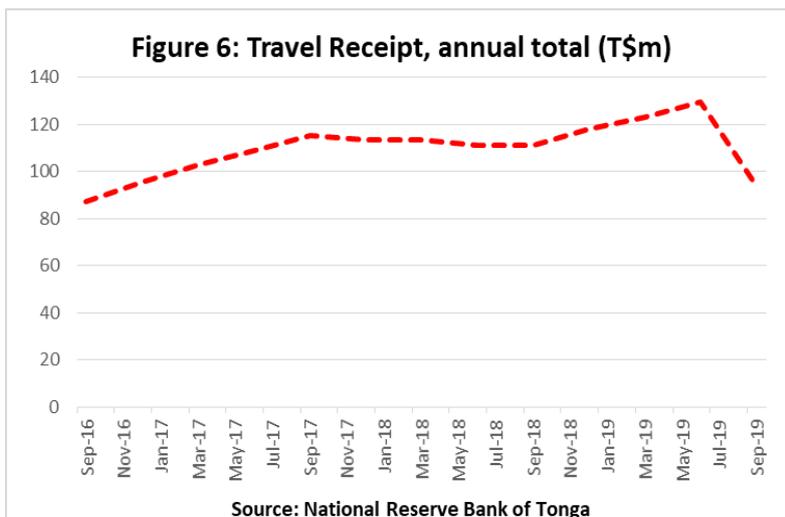
## TERTIARY

The economic activities under the tertiary sector were driven mainly by the growth in the: **Wholesale and retail trade sub-sector**, through the increased receipts from remittances; and **Transport and communication**, through the increased number of vehicles registration and the coming into the market of the M. V. Tongiaki and M.V Taka-'I-Pomona and facilitated the distribution of goods and services to the outer-islands.



The positive trend reflects remittances significant impact on the economy and link to our traditional values and culture. Further, this also reflected the continuing good relationship with Tongans in diaspora.

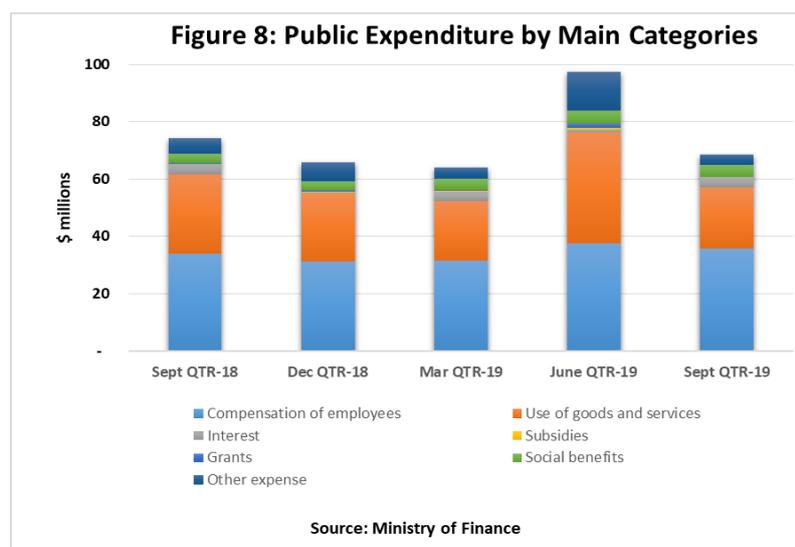
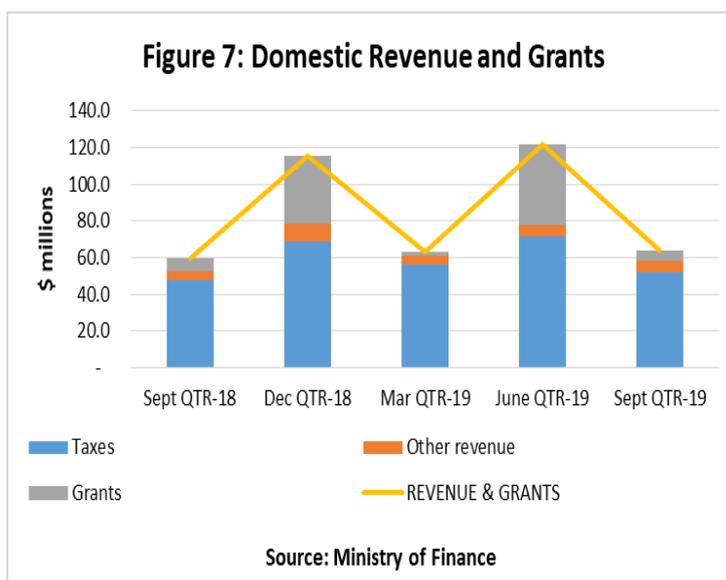
Alternatively, the amount of travel receipts decreased by 27 percent compared to the previous quarter mainly due to decrease in the international arrivals, end of national events such as Heilala festivals in previous quarter.



Outlook for the sector was forecast to be positive in considering the arrangements were being finalized with Tour operators for more cruise ships to arrive in Tonga in the medium term and the continuous contributions from seasonal workers and families overseas.

## FISCAL SECTOR

Domestic revenue and grants were estimated to rise slightly by 6.9 percent at the end of the September quarter 2019 compared to the same period in the previous year, due to the increase collection of domestic revenue by 8.6 percent. On quarterly basis, domestic revenue and grants received in September quarter 2019 were around 47 percent lower than the previous quarter. The decreased in quarterly receipts were mainly due to decrease in collection from income tax, corporate taxes for both small and large businesses, and withholding tax for both residents and non-residents. However, it was noted that the receipts of \$5.4 million as a capital grant during the review quarter was from the foreign government and International organization such as World Bank and ADB.



Provisional data indicated that government expenditure for September quarter 2019 was around 29 percent, lower than the previous quarter and 7.7 percent lower than the corresponding period in the previous year respectively. The decrease in the quarter was mainly due to lower payment made at the first quarter of the 2019/20 financial year for compensation of employees. The implementation of the policy to pool all vacant positions to Ministry of Finance in the effort to control the total wage bill

became effective at the beginning of the review quarter. Other factors that contributed to the reduced quarterly expenses include the decreased in costs for use of goods and services, subsidies for development committees, grants, social benefits for social welfare scheme and vulnerability, pensions & gratuities and other expenses.

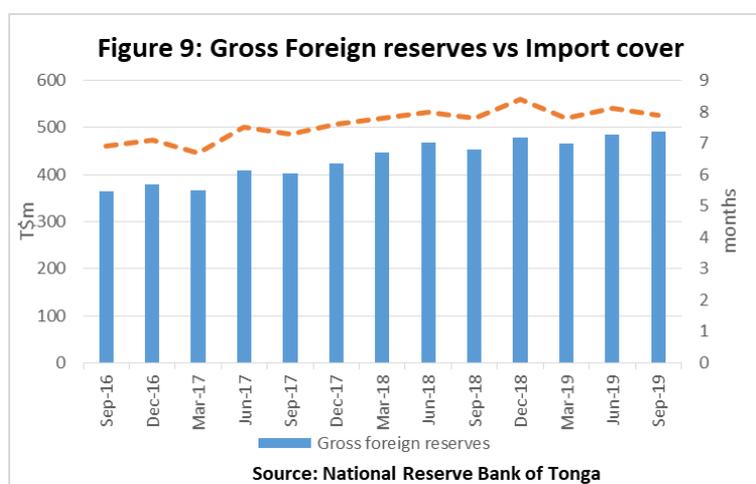
At the end of September 2019, the operating fiscal balance recorded a fiscal deficit of \$4.7 million compared to a surplus of \$24.3 million on the previous quarter. The deficit in the reviewed quarter was from the total receipts of tax and grants amounted to \$63.7 million compared to the total spending of \$68.5 million on the same period.

## EXTERNAL SECTOR

The expected earnings from export at the end of September quarter 2019 was lower in compared to the previous quarter. On year-on-yearly basis, it was higher than the corresponding period in 2018. The decline in the quarterly trend was mainly due to decrease in fish and other marine exports such as tuna, snapper and aquarium. The increase in the annual trend was supported by the increase in agricultural exports of taro leaves and roots crops such as cassava, giant taro, yam and squash pumpkin. The Overseas Exchange Transactions Trade balance account for the next quarter was unfavorable due to increase in payments for imports, contributed to increase in transfer balance. The increase in remittances and other official transfers was due to the Christmas and New Year season, family reunions and other functions all contributed to the increase in the number of transfers made during the quarter.

A positive Balance of Payment (BOP) was forecast going forward should the export of squash pumpkin improve in addition to the increase exports of other agricultural products and fisheries.

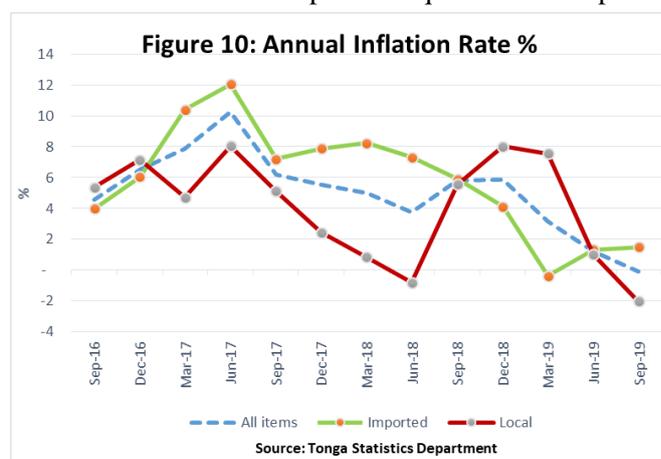
The level of gross foreign reserves recorded at the end of September 2019 was \$490.8 million; equivalent to 7.9 months of import cover. This was around 1 percent higher, by \$6.5 million, in compared to the previous quarter and about 9 percent or \$38.6 million higher than what was recorded at the end of September 2018. The increase on quarterly basis was mainly due to higher receipts from budget support and foreign aid during the review period. The 7.9



months of import cover highlights a fact that Tonga continues in a comfortable external position that far surpasses the minimum range of 3 – 4 months set by the NRBT.

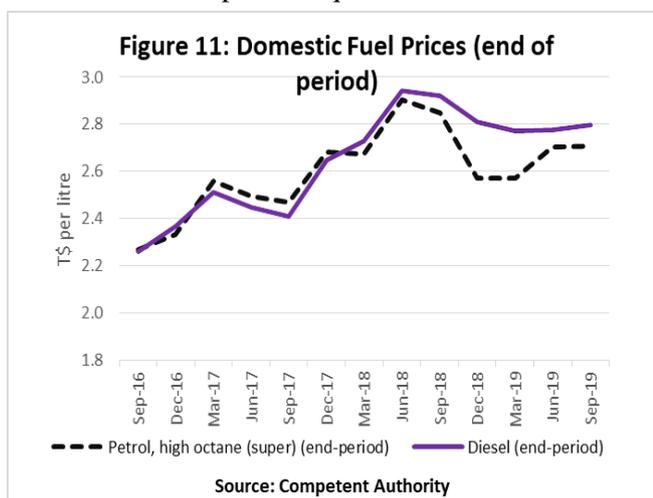
## MONETARY AND FINANCIAL SECTOR

The annual inflation rate at the end of the September 2019 was - 0.07 percent compared to 1.2 percent recorded at the end of the previous quarter and 5.8 percent at the end of September 2018. The significant

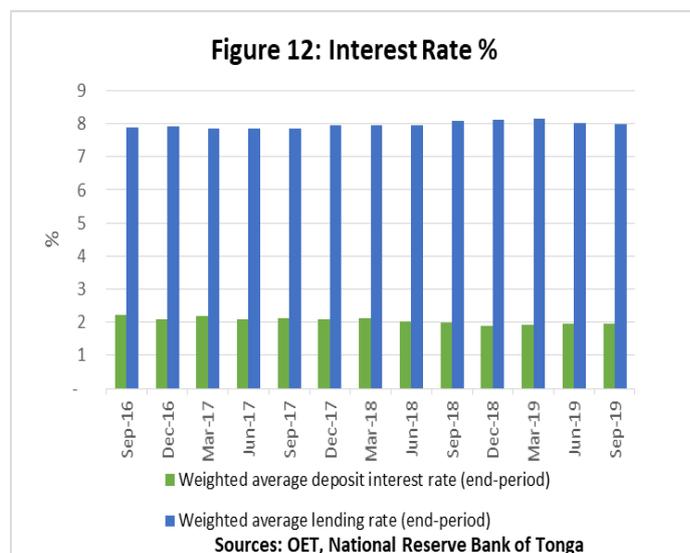


decrease from previous quarter was mainly driven by imported inflation component with an annual inflation rate of 1.5 compared to - 2.03 from the local component. The lower domestic prices was driven by the decrease price of Kava, Tongan Tobacco, local food such as roots crops, vegetables, eggs. The increase in prices of imported food was driven by alcoholic beverages, tobacco and items meat and poultry. In addition, the appreciation of the NZ and Australian dollars also contributed to the increase in price of

import. Domestic price for both petrol and diesel at the end of September quarter 2019 remained stable when compare to previous quarter. On year –on –year comparison, both prices decrease when compared to the corresponding period in 2018. This is consistent with the upward movement in global oil prices index on year-on-year basis as well the depreciation of the Tongan Pa’anga (TOP).



Weighted average deposit interest rate at the end of September 2019 remained at 1.94 percent the same level as in the previous quarter. However, it was lower by 0.04 percent in the same quarter in previous year. On the other hand, weighted average lending rate was 8 percent in the review quarter, lower than both the previous quarter and the corresponding period a year ago. The decline resulted from lower lending to state owned enterprises, wholesale & retail, manufacturing and construction sectors.



On period average for the end of September 2019, Tongan Pa’anga was weakened against the US dollars while strengthened against Australian and New Zealand dollar in compared to the previous Quarter. The depreciation in the Tongan Pa’anga benefitted the recipients of remittances in Tonga and increase in demand for goods and services and imports. However, cost of imports would increase and cause upward trend of inflation if the weakening of the exchange rate continues

## **RISKS**

The outlook for the Tongan economy in the medium term remains positive; however, there are potential risks that may affect our projections. Tonga high vulnerability to natural disaster and climate change post a higher risk to our forecast for the Primary sector as witness by the impact of TC Gita to the country. In addition, scale down and delays in the commencement of major construction projects could lead to a revised down of growth in the construction sub-sector and dampen our growth projections in the near term.

The development in the global market and in the economies of our main trading partners will definitely impact Tonga's economic activities and overall GDP growth. This is due to Tonga's high dependence on these economies; a slow-down in any of them would result in lower remittances, aid, household disposable income and demand for Tonga's exports.

## **CONCLUSION AND POLICY ISSUES**

Tonga economy is vulnerable to external shock and relies on assistance by its development partners and remittances from Tongans' abroad. It is therefore important to maintain regular monitoring and review of our fiscal and external situation and existing policies to maintain macroeconomic stability. Further, it is also important to ensure the economy is resilient to cope with adverse shocks (both economic and disaster) in the short term. In the longer term there's greater need to boost public investment and reduce dependence on aid and remittances. Additionally, it is also important to continue to sustain the level of budget supports from development partners to drive achievements of set targets for the economic and social sectors.

In considering the experience and impact of recent disasters, government and its key stakeholders are encouraged to continue working in collaboration to implement preventative measures to address future disaster and climate change related risks. This include enhancing local capacity to construct more climate-resilient infrastructure and development of policy that promote direct responses and coordination to climate change and disaster risk reduction. This promotes Government effort towards prudent fiscal expenditure that could result from costs of future natural disasters.

With that being said, 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 programs, close monitoring of the TSDF II outcomes as well as the medium-term expenditure framework and debt strategy.