

**HALF-YEARLY  
REVIEW**



**ECONOMIC  
2014/15**

*(July-December 2014)*

**NATIONAL PLANNING & ECONOMIC DEVELOPMENT DIVISION  
MINISTRY OF FINANCE & NATIONAL PLANNING  
GOVERNMENT OF TONGA  
*March 2015***

## INTRODUCTION

This half yearly economic review report presents an overview of the economic development for the first half of the current financial year 2014/15 and comments on the outlook for future.

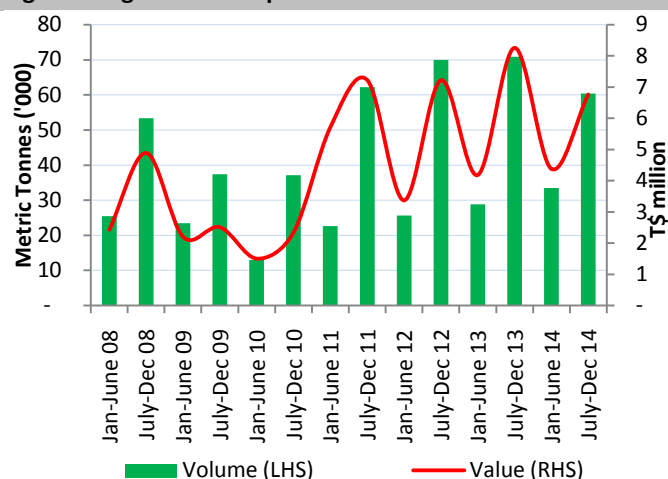
## HIGHLIGHTS

- After a revised contraction in GDP of minus 2.7 percent for FY2013, the Statistics Department estimate that the economy grew by 2 percent in FY2014 supported by strong growth in the agriculture sector and public construction projects. This is slightly stronger than we had anticipated in our forecasts in the 2014/15 Budget Statement. This was mainly due to the underestimating of the agriculture sector. We had anticipated weak growth in line with an observed decline in squash exports. However, growth in production of other products was strong enough to offset this.
- Real GDP growth is expected to weaken in FY2015. This is largely due to the observed effects of the ongoing drought conditions across the islands. Production in the agriculture sector has declined, affecting both export and domestic production volumes. Export receipts for the first half of FY2015 were \$11.7 million - this is 10 percent lower than the first half of FY2014 and reflects lower proceeds from the exports of agriculture.
- The average power tariff decreased in the first half of FY2015, to 91.22 seniti per kilowatt from 93.31 seniti per kilowatt in the corresponding period last year (down by 2.24 percent). The power tariff was further reduced from 80.27 seniti/kw to 75.00 seniti/kw in March 2015, reflecting the sharp fall in oil prices since August 2014. This will reduce the cost of living for households and cost of production for businesses.
- Travel receipts increased by 6 percent in the July – December 2014 period from T\$48 million in the same period a year ago. This is much faster than the 4 percent increase in tourist air arrivals. Receipts are expected to further strengthen towards the end of FY2015 as more tourists and visitors are expected for the Coronation on 4<sup>th</sup> of July.
- Foreign reserves at the end of December 2014 were T\$293.6 million which was 8 percent higher than December 2013. This reflects the receipt of budget support from Papua New Guinea and the World Bank during the period. Import cover remains at an average of 9 months.
- Average annual inflation for the first half of 2014/15 was 1.4 percent – lower than the average of 3.7 percent in the previous six months. This was mostly driven by an overall decrease in both domestic and local inflation.
- The level of total public debt was T\$392.97 million at the end of December 2014, a 3.8 percent increase from a year ago. Public debt is equivalent to 46 percent of nominal GDP. The increase was mainly due to the depreciation of the Pa'anga against most of the borrowing currencies and other factors such as new borrowing, sale of bonds, World Bank budget support, and some drawdown for Ha'apai. Total public debt is expected to increase further to T\$400.17 million by the end of FY2015.
- Government domestic revenue for the first half of FY2015 was T\$97 million, up 18 percent compared to the corresponding period last year. This stronger revenue is due to higher intake of taxes on income, profits and capital gains, and was also supported by higher revenue from taxes on goods and services. The revenue collected during July – December 2014 is 57.4 percent of estimated total domestic revenue for the year reported in the last Budget Statement.
- Government payments made in July – Dec 2014 totalled T\$105.2 million, 22 percent lower than the amount for the same period last year. Lower payments were mainly due to a 16 percent

decrease in current expenses. This is only 23 percent of estimated total government payments for the year reported in the last Budget Statement.

## REAL SECTOR DEVELOPMENT

Figure 1: Agricultural Exports



Source: Tonga Statistics Department & MAFF (Quarantine Division)

## AGRICULTURE

The agricultural sector accounts for 15 percent of real GDP. Following strong growth since FY2010, volumes of agricultural exports increased at a slower pace of 2 percent in FY2014. This compares to growth of 6 percent and 12 percent in volumes and values in FY2013. Weaker growth reflects a 12 percent decline (year-on-year) in the volume of squash exports - due to the exit from the market of the largest squash exporter. However, growth in remaining non-squash commodities such as cassava,

yam, taro tarua, kava, and coconuts was strong enough to maintain reasonable growth in total exports. In addition, information from market contacts suggests that squash production will adjust back to its normal production and exports are anticipated to strengthen in FY2016.

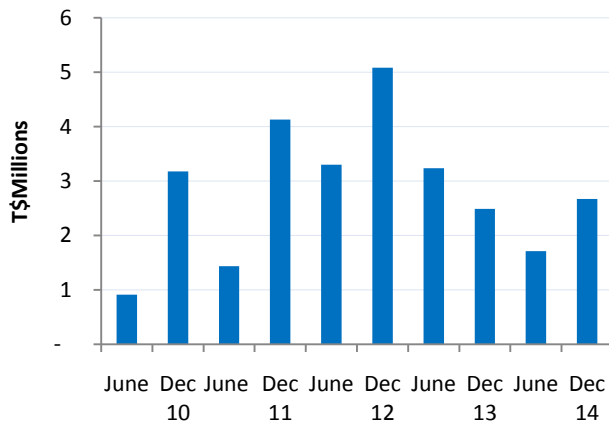
The drought that began in April 2014 brought about by the strong El Nino weather pattern has had a significant impact on agricultural production in the first half of FY2015. Total agriculture export volumes are down by 15 percent in July-December 2014, relative to the same period in 2013. The volume of squash exports has declined by 42 percent in this period.

Minimal squash exports are expected for the remainder of the fiscal year as the main squash harvesting period is from July-December. Exports of non-squash commodities are also expected to decline as a result of the drought. Domestic market and subsistence production is also expected to decline by 11 and 2 percent in FY2015.

The government has provided lending support to the sector, and this may be helping to support the level of activity in the sector. However, the size of the fund is small relative to GDP in the sector, and only 33 percent of the fund has been lent out so far. The impact of this lending on the sector will depend on the effectiveness of the initiatives being funded, particularly whether they are funding investment or current production. The fund has been utilized for squash and root crops exports so far. Overall, we expect the loan fund to support activity, but may not provide a significant boost to growth.

Over the medium term, the main limiting factors affecting the sector's performance will be the capacity of the sector to adapt to changing climate conditions, and the high cost of production as raised by the sector committee during TSDF I consultation. However the Government has recently (in November 2014) revised the criteria for the loan fund to make it easier for accessing by the growers and exporters. This helps to reduce the cost of finance.

**Figure 2: Fisheries Exports**



Source: Ministry of Agricultural, Food, Forestry and Fisheries

## FISHERIES

The fisheries sector accounts for 3 percent of real GDP. Receipts from fisheries exports increased 7 percent in July-December 2014 compared to the same period in 2013. This follows declining export receipts from the sector since December 2012. The main contributors to this growth were strong increases in tuna and sea cucumber (mokokunu) exports— up by 108 percent and 90 percent respectively. Renewed growth in the sector may have been supported by the recent exemption of fisheries related inputs

from CT and duty (such as bait, fishing equipments, boats etc). The number of such exemptions increased by 76 percent compared to the first half of FY2014. Looking forward for the remaining of FY2015; tuna exports, snapper and shark are expected to strengthen.

Following damage to fishing boats and equipment, a slow recovery in domestic fishing activities is anticipated in Ha’apai during financial year 2015. This is supported by a project funded by FAO to train local people in affected communities how to fix fishing nets and repair fishing boats.

Production in the sector is always subject to fish migration, weather and sea conditions, market conditions and other factors. Growth in the sector may be supported by the provision of the Fisheries Development & Export Fund Loans, which aim to assist local fishermen, vessel owners and exporters to grow income and employment in the fisheries sector. However, given the size of the loan fund is very small, its impact on GDP in the sector may be minimal. In general, access to funding is not a constraint at present given the continuance in government concessional loans.

Poor infrastructure is cited by industry contacts as main challenge for the sector. Some foreign vessels they are licensed to fish in our waters and never unload here, they end up unloaded in neighboring countries as they have better infrastructure at wharf. The performance of the sector may be underreported at present as catches may be unloaded in neighboring countries and therefore not captured in our export data.

## MANUFACTURING

Growth in the manufacturing sector has been volatile over the last few years. We had projected positive growth for FY2014 in the last Budget Statement reflecting the new entrants into the local beer brewing industry and the increase in the production of virgin coconut oil. The actual weakness in FY2014 may reflect the production of handicrafts in Ha’apai being disrupted after the cyclone destroyed pandanus and root-crop inputs.

The number of manufacturing businesses registered increased further by 18 percent in 2014 suggesting positive growth in FY2015. We assume that the new capacity adds to realized value added in the sector and will be met by stronger demand, rather than simply dispersing current demand

across more businesses. We would expect this growth to be accompanied by an increase in CT paid from manufacturing businesses. However, this will depend in part on enforcement and compliance. The expansion of Cowley Bakery to their branch at Fasi in 2014 and increasing sales of wood products (by Tonga Forest Product) have also contributed to the improvement in the sector.

## CONSTRUCTION

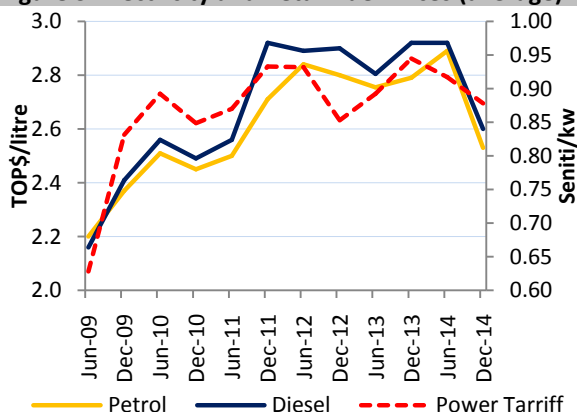
Construction activity recovered in FY2014 following a sharp contraction in FY2013 due to the end of the China funded reconstruction of Nuku’alofa. Growth in construction activity is expected to strengthen further in FY2015 due to both increased activity in the private and public sector construction. In terms of the private sector, the number of building permits issued in FY2014 was 205 – decreased by 19 percent compared to FY2013, with 60 percent of the permits issued in the first half FY2014. Private sector construction is expected to have strengthened in July-December 2014 in line with strong growth in new commitments of housing loans. The strong increase in new commitments in the first half of the current fiscal year appears to be due to the new MBF’s housing loans scheme that was first initiated in February 2014. Other private construction (including church building projects) remains active around Nuku’alofa and outer islands.

Public sector construction will be supported in FY2015 by key government construction projects such as Ha’apai Reconstruction, Pacific Aviation Investment Project (PAIP) – the resurfacing of Fua’amotu and Lupepau’u airports, stage II and III of Tonga Village Network Upgrade Project (TVNUP), extension of fiber optic cable to outer islands (Vava’u & Ha’apai) and others. There is a large pipeline of new projects over coming years including government office building, the upgrading of Fua wharf and preparation for the Pacific Games.

The main risks to the projections for the construction sector are delays in construction projects due to pressure on resources or funding constraints. Delays would cause weaker performance in the sector in the current year, but assuming projects are delayed and not cancelled or scaled back, these activities would move to outer years.

The growth in mining and quarrying is assumed to be in line with the growth from construction activities.

**Figure 3: Electricity and Retail Fuel Prices (average)**



Source: Competent Authority (MCTL) & Tonga Power Ltd

## ELECTRICITY

The sharp falls in oil prices since August 2014 directly reduces the fuel component of the power tariff. The lower price and the unusually hot weather increased demand for electricity and consequently lead to an increase in production. The spot world oil price (WTI) decreased 15.9 percent between July – December 2014 and has continued to decline through the beginning of 2015. This has caused the local price of diesel to decline by 5.5 percent to around T\$2.77/liter. The average power tariff decreased in the first half of FY2015, to 91.22 seniti per kilowatt from 93.31 seniti per kilowatt in the corresponding period last year (down by 2.24 percent). The power tariff is set to decline further to 75 seniti per kilowatt in March 2015 due to the continued falling in world oil prices and supported by the usage of non-renewable energy (solar energy and others).

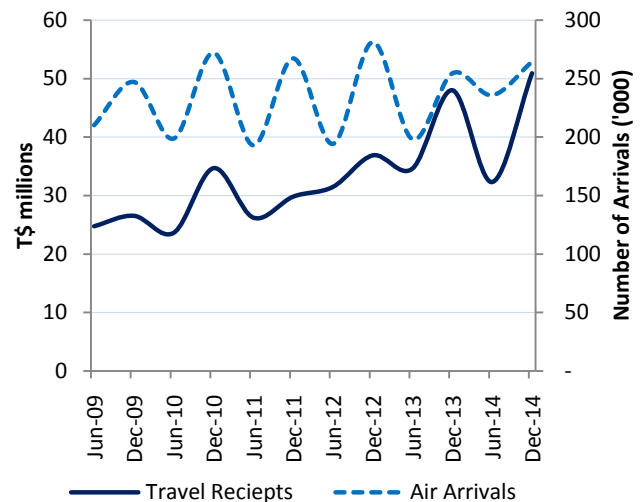
Average local consumption of power increased by 0.9 percent during the first half of FY2015 compared to previous 6-month period and 2.2 percent compared to the same period last year. This was in line with an increasing import of high power consumption appliances and supported by the strong growth in construction activities.

### HOTELS AND RESTAURANTS

Travel receipts are expected to increase by 6percent in July-December 2014 from T\$48 million in the same period year ago. This is much faster than the 4 percent increase in tourist air arrivals.

Robust performance for the sector is expected in the second half of FY2015 as more tourists and visitors are expected for the Coronation in July 2015. Travel receipts are anticipated to increase and spending on restaurants, handicrafts, and recreational and cultural activities are also likely to increase. Renovation of accommodation is expected to increase ahead of the coronation – also contributing to stronger private sector construction activity.

**Figure 4: Travel Receipts vs. Tourist Air Arrivals**



Source: Competent Authority (MCTL) & Tonga Power Ltd

The continued provision of the government concessional loans (to promote the development of new tourism products & events, improve the quality of small-medium accommodations, help the development of a clean and beautiful tourist environment, assist in the development of heritage sites and cultural events), along with improved coordination within the tourism sector will help to maintain the performance of the sector in the future. However, the loan fund remains small relative to the size of the sector, therefore it's impacted on GDP growth may only be mild.

### TRANSPORTATION & COMMUNICATION

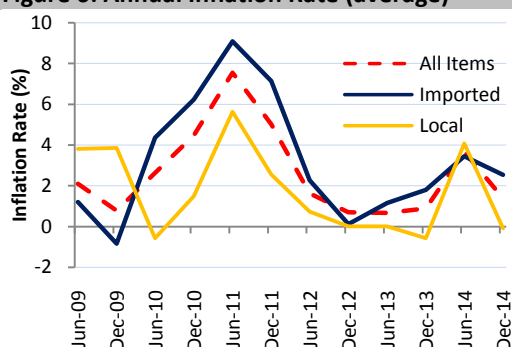
Strengthening growth in transportation is consistent with a strong increase in the number of new vehicles registered in the first half of FY2015 compared to previous years. Further growth in registrations is expected as the size of the fleet of government vehicles is increased ahead of the coronation in July 2015. The sharp fall in oil prices during the year has meant lower costs in the sector further supporting stronger growth.

Domestic shipping services are expected to remain relatively strong, as domestic passenger numbers have increased. Shipping activity will be also boosted by higher demand for transportation of aid equipment and materials to Ha'apai for the reconstruction. Positive growth is also expected for international shipping services, in line with an increase in number of cruise ships visiting the Kingdom – 16 cruise ships are planning to dock in Nuku'alofa in 2015, compared to 11 ships in 2014. The upgrading of Fuaa wharf will raise capacity to accommodate further increases in domestic and international shipping services.

In terms of air transportation, an overall increase in the number of international air arrivals is anticipated during FY2015 due mainly to the Coronation in July. Upgrades and expansion of airport capacity may support future growth.<sup>1</sup>

The installation of fiber cable has reduced the wholesale price of bandwidth to telecommunication operators by about 80 percent. The speed has increased several folds. Prior to the cable, the lowest price of an internet package available from a service provider was T\$113. Currently a price of T\$29.95 is being advertised by one service provider. The extension of the fiber optic cable to outer islands such as Vava'u, and Ha'apai should support the performance of the communications sector in the future.

**Figure 6: Annual Inflation Rate (average)**



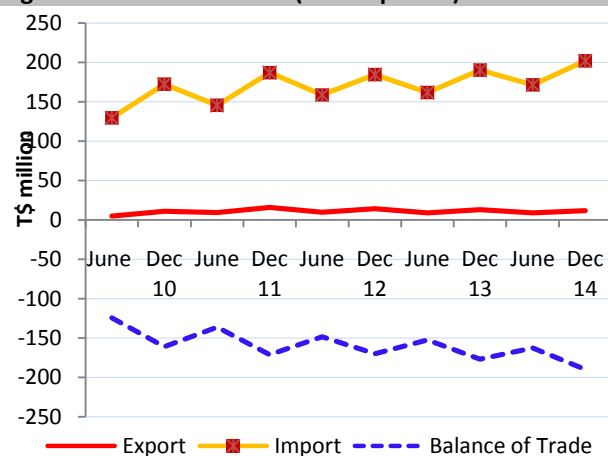
Source: Ministry of Finance and National Planning

## INFLATION

For the six months ending December 2014, the average annual inflation rate was 1.4 percent. This is lower than the average of 3.7 percent in the previous 6-month period. Both domestic and imported inflation were low, both in part due to the sharp falls in oil prices through late 2014.

## EXTERNAL DEVELOPMENTS

**Figure 5: Balance of Trade (end of period)**



Source: Statistics Department

Exports receipts for the second half of FY2015 are expected to decline by 10 percent compared to the same period last year and are expected to remain weak for the remainder of FY2015. This is consistent with declines in agriculture exports mentioned earlier.

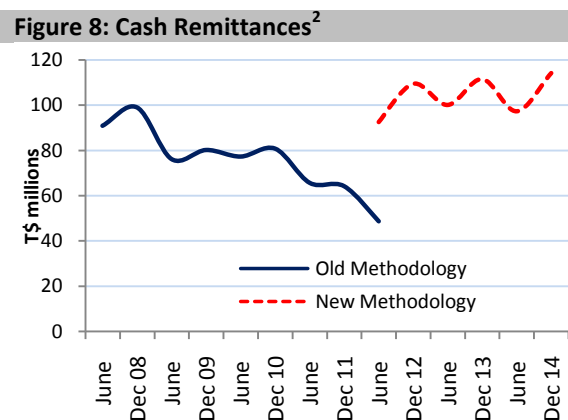
Import payments are expected to increase by 6 percent in the first half of FY2015 compared to the same corresponding period in FY2014. This is consistent with an increase in imports of construction related materials. As a result, the balance of trade deficit is anticipated to

widen by around 7 percent compared to July-Dec 2013.

<sup>1</sup>The implementing of Pacific Aviation Investment Project (PAIP) - upgrading and resurfacing of Fua'amotu and Lupepau'u airport may support future growth in the sector. The further extension of Lupepau'u airport to meet the standard of international airport could contribute to future growth.

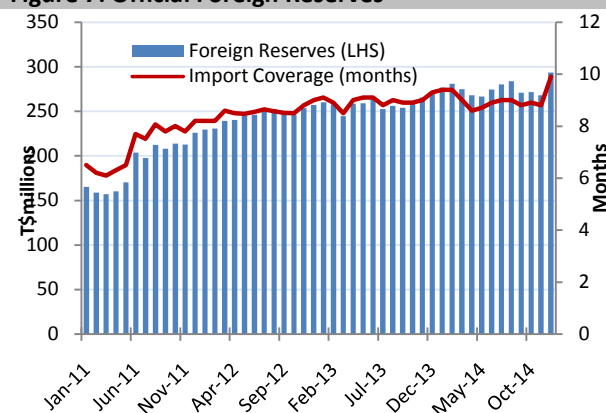


Total estimated cash remittances for July-Dec 2014 were T\$114 million. This is 17 percent higher than the previous period reflecting a seasonal pattern in the data as higher remittances are sent around Christmas and the New Year. Comparing remittances to the same period of the previous year, they are 2 percent higher. Remittances are anticipated to remain fairly strong supported by the increasing in number of seasonal workers overseas and continuing strong relationship between overseas Tongans and relatives in Tonga. The number of seasonal workers increased from 3,035 workers in FY2014 to 12,250 workers in FY2015



Source: National Reserve Bank of Tonga

Figure 7: Official Foreign Reserves



Source: National Reserve Bank of Tonga

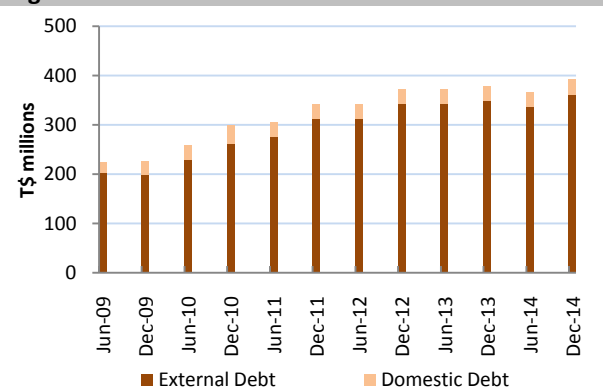
### FOREIGN RESERVES

Official foreign reserves held by the National Reserve Bank (NRBT) remain high at T\$293.6 million. This is 9.6 percent higher than the previous month and 8 percent higher than the corresponding period a year ago. This is equivalent to 9.9 months of import cover, which is higher than any month during the year. The increase in foreign reserves in the last quarter was mainly driven by the receipt of budget support from World Bank in December 2014 (equivalent of T\$4.8m) and an increase in remittances during the second half of FY2015.

### PUBLIC FINANCE DEVELOPMENTS

At the end of December 2014, the level of total public debt was T\$392.97 million - a 3.8 percent increase from a year ago. As a ratio to nominal GDP, public debt is 46 percent. The increase in debt reflects the depreciation of the Pa'anga against most of its borrowing currencies. External and domestic debt increased by 3.7 percent and 5 percent to an estimated amount of T\$361.99 million and T\$30.98 million respectively. External debt is anticipated to increase in the future, as a change in Tonga's debt status changes the mix of budget support and project funding from the World Bank and ADB from 100 percent grants, to 50 percent grant and 50 percent concessional loan.

Figure 9: Total Public Debt

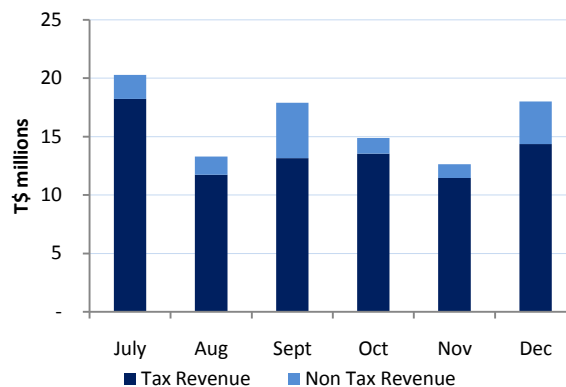


Source: Ministry of Finance and National Planning

<sup>2</sup>At the end of 2013, the NRBT improved its methodology for measuring the foreign exchange transactions in Tonga, merging the OET data with information obtained directly from foreign exchange dealers. All data back to, and including the first quarter of 2012 were revised, resulting in a large series break at the quarter (refer to red dotted line in Figure 8).

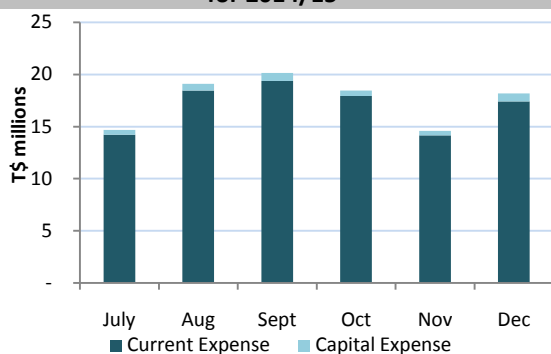
Total government domestic revenue collected in the July-December 2014 period increased by 18 percent to T\$97 million compared to the corresponding period last year. This amounts to 57.4 percent of the estimated total government domestic revenue for the year reported in the 2014/15 Budget Statement. The increase was driven by an increase in revenue collection from income, profits and capital gains (up by 60 percent). This was due to the payment of a significant sum of arrears from a government business in July 2014. Revenue was also supported by an increase in taxes on goods and services, up 7 percent during the period and in line with a 15 percent increase in imports.

**Figure 10: Total Monthly Government Domestic Revenue for 2014/15**



Source: Ministry of Finance and National Planning

**Figure 11: Total Monthly Government Expenses for 2014/15**



Source: Ministry of Finance and National Planning

Total government payments made in July-December 2014 decreased by 22 percent to T\$105.2 million compared to corresponding period last year. Payments in the period amount to 23 percent of estimated total government payments for the year reported in the 2014/15 Budget Statement. The low level of payments is mainly due to compensation of employees being 35 percent lower than in the same period of FY2014. The bulk of the government expenditure will be incurred in the second half of FY2015 in preparation for Coronation in 4<sup>th</sup> July.