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Ministry of Finance & National Planning

July-December, 2008

## Economic update for 6 months

### July-December 2008

#### Inside this issue:

Introduction & Highlights	1
Real Sector Development	2
Agriculture	2
Fisheries	2
Manufacturing	2
Construction	2
Electricity & Water	3
Tourism	3
Transportation & Communication	3
Price Developments	3
Monetary Sector Development	3
External Sector Development	4
Public Finance	4
Economic Outlook	5
- Half Yearly Budget Outturn 2007/08	

#### Introduction & Highlights

This Half Yearly Economic Review Report presents an overview of the economy as a whole for the six months of the current financial year 2008-09. The government overall position for the six months period under review recorded a surplus of \$13.58 million pa'anga. Agriculture and Fish which still accounts for the largest share in the country's Gross Domestic Product has shown sign of decreasing mainly due to further falls in squash and domestic productions. Inflation is still gradually growing at 6.4% at Dec 08, a fall from 12.2% in June 08 mainly due to a decrease in imported items as well as fluctuation of prices in the domestic market. Official Foreign Reserve still benefit from favourable exchange rates and declining oil prices which has increased for the past six months. Money Supply and Total Liquidity as recorded by the Reserve Bank has increase by \$26 million pa'anga for Dec 08.

Headline Indicators	Dec 08 Values (\$m Pa'anga unless otherwise indicated)	% Change (vs Jan-June 08)	% Change (vs Jul-Dec 07)
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#### Monetary Indicators

Annual Inflation	6.4%	↓47.54%	↓5.88%
Retail Fuel Prices			
Petrol: \$2.74/ltr		↓11.33%	↑3.40%
Diesel: \$2.84/ltr		↓16.72%	↑2.16%
Foreign Reserves	\$123.9	↑39.06%	↑8.12%
Import Cover	4.9 months	↑40.0%	=

#### Economic Activity

Remittances	\$49.9	↑9.29%	↓12.1%
Tourist Receipts	\$9.68	↑30.78%	↓18.8%
- Arrivals	14,776	↓20.32%	↓17.2%
Fish Receipts	\$2.6	↓2.12%	↓12.4%
- Metric Tonnes	125.1 m/tonnes	↓28.03%	↓28.53%
Trade- Deficit	\$74.3	↓4.89%	↑1.45%

#### Fiscal Indicators

Revenue	\$47.5	↓29.3%	↓5%
Expenses	\$39.68	↓21.04%	↓7%

#### Contact:

**Economic & Social Policy and Planning Division.**

**Ministry of Finance and National Planning. TONGA.**

**Telephone: 23900**

**Fax: 24260**

**Email: [policy@finance.gov.to](mailto:policy@finance.gov.to)**

### 3.0 Domestic Economic Conditions

#### 3.1 Real Sector Development

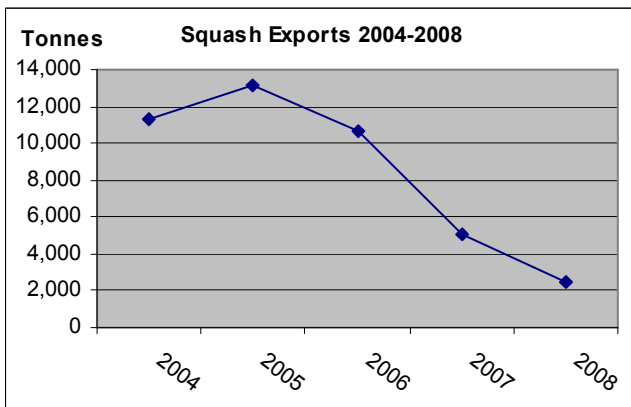
Indicators suggested that the economy has, inline with its events, performed below levels forecast at the time of the 2008 Budget. This is mainly due to a combination of factors including unfavourable prices of squash exports as well as declining domestic production and for the impact of the financial crisis on our main market of exports.

#### 3.2 Agriculture

##### Export Production

As the Squash season is now over the number of tonnes exported has been confirmed. Only 2447 tonnes were exported in 2008. This was first time for Squash to be exported in cooler container. Unfortunately more than half of the total exported was rejected as it was rotten on arrival due to longer than usual duration of shipping. Hiring of a dedicated shipping vessel for squash was not possible due to high transportation costs and low volumes.

Figure 1

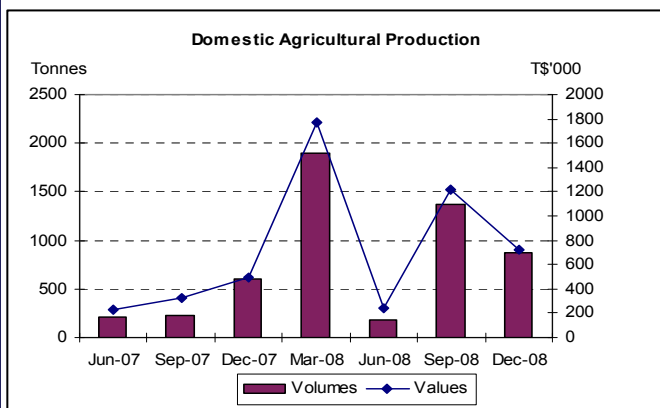


Despite these difficulties, the Squash industry retains confidence in the future of the industry.

##### Domestic Production

Domestic agriculture production is recorded as declining during the last quarter of 2008. Further decline is projected due to concerns about high labor costs, and decreased local demand.

Figure 2



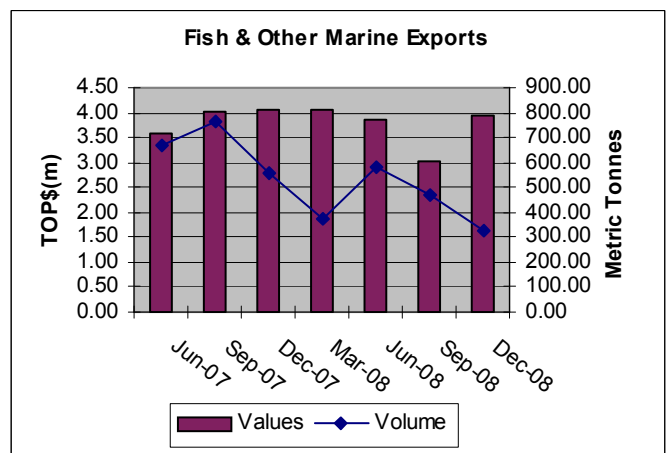
This data must be treated with some skepticism, however, as it only records produce sold at Talamahu market. Produce sold on the roadside or outside of Nuku'alofa is not captured.

#### 3.3 Fisheries

##### Fish and Other Marine Exports

Fish and other marine exports products have been decreasing since September 2007 as illustrated on Figure 3. The financial crisis has affected their main market which is the United States. New markets have been obtained in China, however, Tongan products are at a competitive disadvantage due to the existence of a 40% import duty. A new market has also been opened to Dubai.

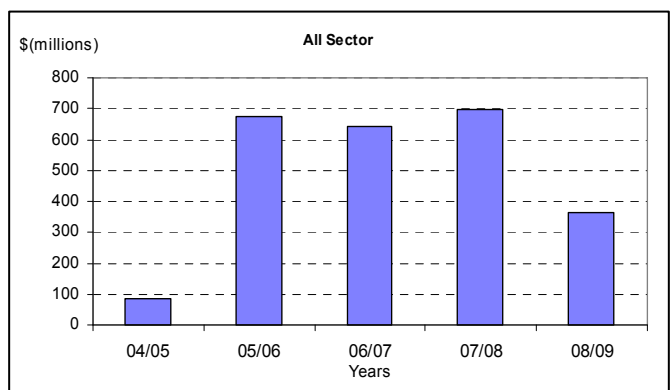
Figure 3



#### 3.4 Manufacturing

This data is based on businesses CT Returns. Returns for the last seven months are shown by 2008/09.

Figure 4



#### 3.5 Construction

The number of building permits issued in 2007 was 253. For the last six months, 108 building permits were issued and this number is likely to double in the second half of the year.

Therefore, despite a -0.2% decline in housing loan from September to December quarter 2008, it is expected that the industry will show positive growth driven by the continuation of donor funded projects and churches buildings.

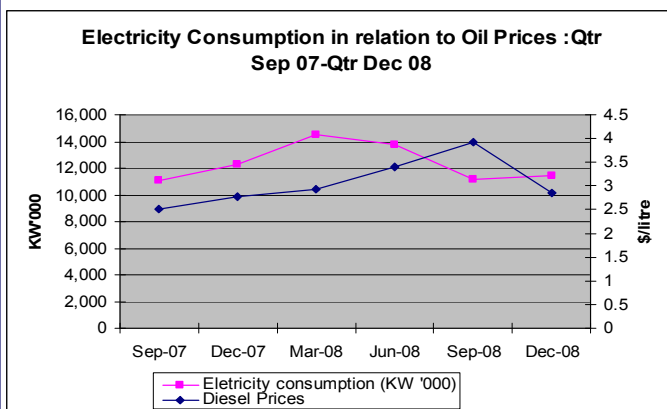
New tourism developments and phase 2 of Vaiola Hospital development are also boosting growth in this sector. The reconstruction of the capital will also positively contribute in this financial year and the subsequent years.

The Mining and Quarrying industry is expected to increase this year in line with increased local demand for construction.

### 3.6 Electricity and Water

Electricity consumption has declined in response to increased fuel prices. This trend may reverse with the planned reduction in electricity prices.

Figure 5

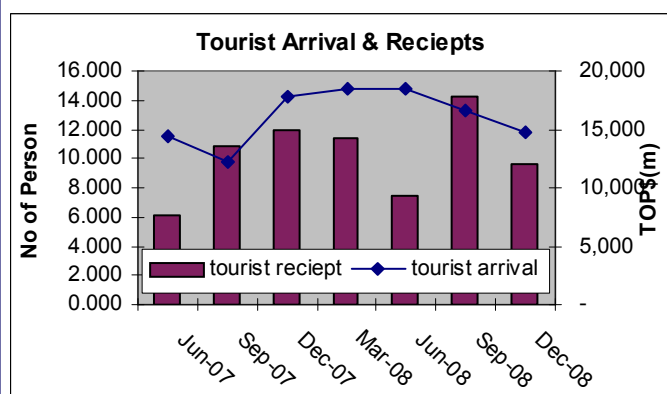


### 3.7 Tourism

#### Commerce, Restaurants and Hotels

The Coronation in Aug 08 significantly improved the performance of the commerce, restaurants and hotels for the Sept Qtr 08, tourist receipts increased in the Sept Quarter as compared to receipt in previous months. The number of tourists arrival in 2007/08 shows that the industry had recovered from the result of the riot in November 16, 2006.

Figure 6



Visitor arrivals decreased in the first quarter of 2008/09 and also on the second quarter. This is in line with the decrease on the tourists receipts from \$14.2 million pa'anga in September Quarter to \$9.6 million pa'anga in the December Quarter 2008.

### 3.8 Transportation and Communications

The launching of Digicel Company and acquiring of Tonfon Communications with its wide range of product and services

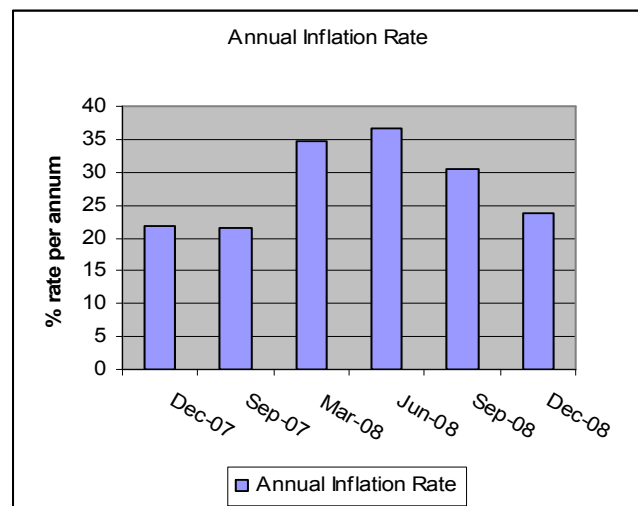
offered increased the level of competition between the two companies (Digicel vs U-Call). This led to a significant reduction in the costs of telecommunications. Their competition has enabled communications to be much easier than before. It is quite obvious that level of demand rises as they compete for the lowest price offered in the market. The limited size of the market may impose a constraint on the contribution by the sector to the overall economic growth.

Costs of air-transport between islands has become more expensive. As a result our private sector tend to suffer from high air transport costs to outer islands in terms of air services, our sea-transport still stands as an alternative for those who cannot afford air services but prices still on a rising trend despite the fact that oil prices fall overtime.

### 3.9 Price Developments

For the six months period of July to December 2008, the average annual rate of inflation was 9.05% compared to 11.2% and 7.3% of the first half and same period of previous year respectively. Inflation rate started to decline after it reached a max for 2008 of 12.6% in May to only 6.4% in December. This compared to 8.1% which was the highest rate in 2007.

Figure 7



According to Reserve Bank, projections that Tonga will likely to experience price deflation from early 09 and will probably continue until 2010.

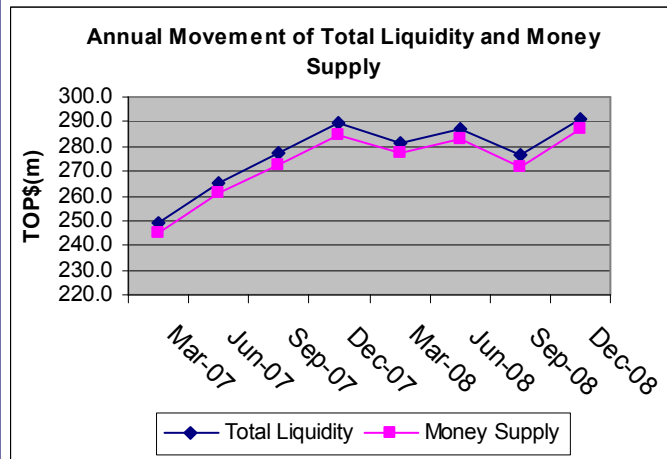
The declining trend of inflation as shown in Figure 7 is attributable to the continuous declining trend in imported item index and fluctuation of price in the domestic market.

### 4.0 Monetary Sector Developments

For the six months period of Jul-Dec 08, Figure 8 illustrates clearly that Level of Money Supply and Total Liquidity have both rise by \$26 million pa'anga compared to an increase of \$24 million pa'anga for the same period of 2007. According to Reserve Bank, possible reason for this increases probably due to increase inflows of funds from abroad, showing that our foreign reserve held increased by \$34.8million pa'anga from \$89.1 mil-

lion pa'anga in June to \$123.9 million pa'anga in Dec 08.

Figure 8

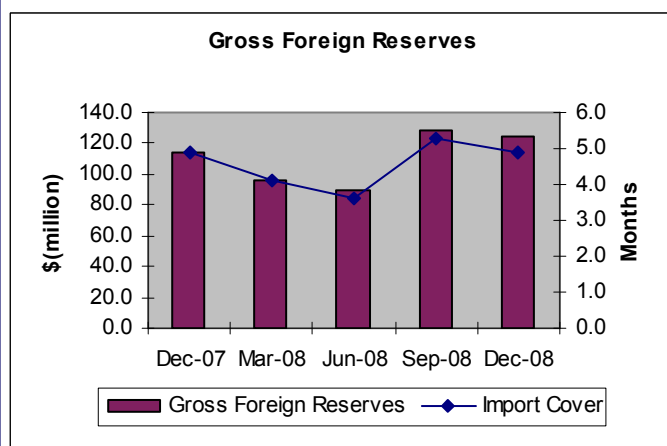


Domestic Credit decrease by 1% for the period Jul-Dec 08 as compared to the same period the previous year. Credit to Private Sector has decrease by \$17.1million pa'anga from \$359 million pa'anga in June 08 to \$341.9 million pa'anga in Dec 08 while Credit to Public Enterprises has increase by \$12.4million pa'anga from \$4.8million pa'anga in June 08 to \$17.2million pa'anga in December 08.

### 5.0 External Sector Development

At the end of December 2008, the level of official foreign reserves was equivalent to 4.9 months of imports, compared with 3.6 months at the end of June and 4.9months at the end of December 2007. Official Foreign Reserves have increased from \$89.1 million pa'anga to \$123.9 million pa'anga for the last six months from June 2008 as Tonga continues to benefit from favorable exchange rates and declining oil prices.

Figure 9



### 6.0 Public Finance (GFS)

The Government overall position for the six months period under review was a surplus of \$13.58 million pa'anga (GFS basis), represented a deficit of \$13.69 million pa'anga from Government fund and a \$27.26 million pa'anga surplus from Grants. The surplus was mainly due to the Grants from China as for Tongasat fund.

The Total Revenue and Grants was amounted to \$110.98 million pa'anga which gives 49.78% of the overall budgeted total revenue and grants and 33% higher than the Total Revenue and Grants obtained in the same period last year . This is less by 0.36 points from the benchmark for the first six months period ended 31st December 2008.

The established benchmark for the first six months was estimated at 50.14% of the total original estimates for 2008/09. Only 18% of line ministries with collection above the benchmark. Revenue Standard Group collected that is above the benchmark included: Income Tax (53.60%), Entrepreneurial & Property Income (74.42%) and Other Non tax items (67.52%)

The Total Expenditure and Net Lending for the period under review was totaled to \$97.40 million pa'anga, a 45.12% of the overall budgeted total expenditure and net lending and 28% higher than the same period last year.

As for Revenue and Grants, the benchmark for Expenditure & Net Lending for the first six months was estimated for 50.14% of the original estimates for 2008/09. Around 36% of line ministries with spending that is above the benchmark. Expenditure by Standard Group that was above the benchmark included interest payments (55.27%) and acquisition of fixed assets (73.05%)

Figures above indicated that less percent (18%) of line ministries with spending above the benchmark. This 36% was attributed for the preparation for Coronation.

