



MINISTRY OF FINANCE

HALF-YEARLY ECONOMIC UPDATES 2019/20

(July 2019-December 2019)

**Economic Analysis
Economic and Fiscal Policy Division
Ministry of Finance
Government of Tonga**

Notes

- a) The following definitions are used in the Half-Yearly Economic Update (HYEU):
- 'Real' means adjusted for the effect of inflation.
 - Real Gross Domestic Products (RGDP) and Nominal GDP are linked through a measure of the price level.
 - The fiscal/financial year (FY) of government ends on 30 June. FY before a calendar year denotes the year in which the fiscal year ends, e.g.; FY2020 ends on 30 June 2020.
 - Forecast period refers to 2019/20 – 2021/22.
- 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)
 - T\$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) Acronyms

AUD	Australian Dollars
CT	Consumption Tax
EU	European Union
EUR	Euro Currency
GDP	real Gross Domestic Product
IMF	International Monetary Fund
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
PEM	Pacific Economic Monitor
PRC	People's Republic of China
TOP (T\$)	Tongan Pa'anga
TASP	Tonga Agriculture Sector Plan
TC GITA	Tropical Cyclone GITA

UK	United Kingdom
USA/US	United States of America
USD	United States' Dollars
WEO	World Economic Outlook

Summary

The global growth rate was estimated to maintain a negative growth in 2019. This was due to the continuous slowdown in economic activities in larger economies, mainly from the ongoing trade tension between China and US. This geopolitical pressure had further steered down the respective growth rates for Asian countries, US, PRC, Japan and further imposed weaken economic expansion in the region.

Overview of Economic Performance, Outlook and Highlights

The end of 2019 estimated a further downward revision in the global growth from 3.0 percent, reported in the Pacific Economic Monitor in December 2019, attributed to the slowdown in activities overall. The leading Economies in the Asia and Pacific Region had shown moderate pace. The US-China trade war had impacts on PRC investments and trade more than expected.

Australia's economy experienced successful Government spending on infrastructure and export, drove growth at an annualized rate of 0.5 percent at the second quarter of 2019. The domestic consumption remained weak despite lower savings rate being reported, implied subdued wages and high household debt within the country.

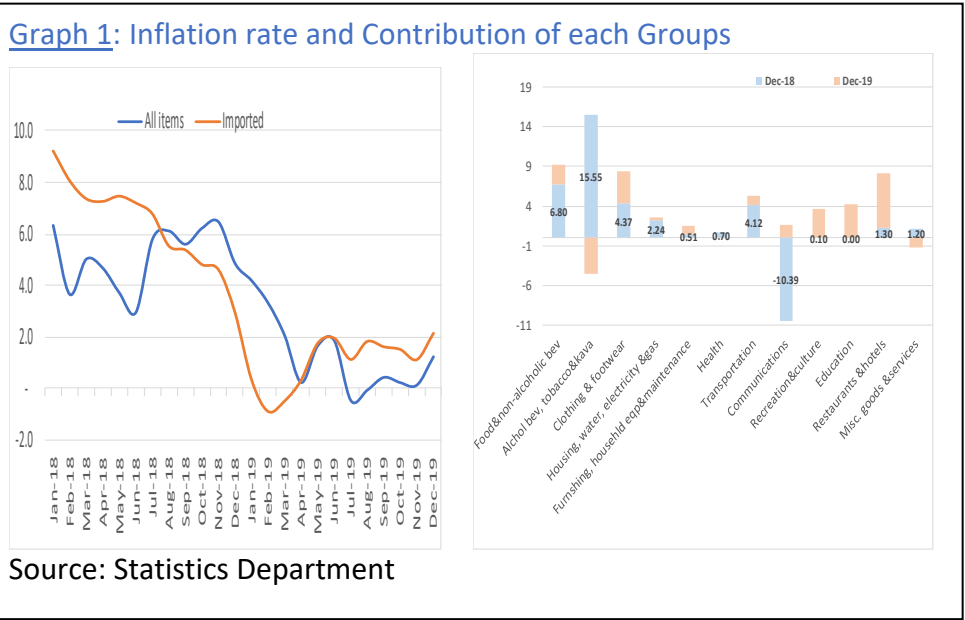
New Zealand economy grew at an annualized rate of 0.5 percent at the second quarter of 2019, largely from its widespread growth across its service industries. On the other hand, the declined in food, beverage and tobacco had softened manufacturing output, led to offset part of the expansion in Agriculture, Forestry and Fishing.

The high liquefied natural gas production of Papua New Guinea, the increased construction expenditure in Samoa and Solomon Islands contributed to the upward revised growth projection for the Pacific subregion by 0.5 percent to 4.0 percent in 2019. The delays in project implementation, slow recovery from cyclones in the region, resulted in a moderate subregional growth of 2.5 percent projected for 2020.

Domestic Economy

- 1. The Tongan economy was estimated to grow at 2.6 percent in 2018/19**, picking up from 0.3 percent growth in 2017/18. The growth was attributed to the improvement in receipts on fishing exports, electricity & water supplies, construction and reconstruction activities following Tropical Cyclone Gita. Inflation rate maintained below the target rate of 5 percent, drove by the declined in the monthly average prices of alcoholic beverages, tobacco and kava. An estimated growth of 3.1 percent was projected for the 2019/20 financial year and positive outlook in the 2020/21 and 2021/22 financial years, due to the large projects scheduled to be implemented during the forecast period.

2. Inflation recorded at 1.2 percent in December 2019, compared to 4.8 percent at the same period in 2018. The average growth rate for the review period was 0.2 percent higher than the average rate of 0.1 percent in the previous month. The disinflation was largely due to decline in average prices of Tongan tobacco and Tongan kava by 3.7 percent and 29.8 percent. However, the growth of inflation over the month, was due to the rising of domestic prices, mainly by the 3.5 percent increase in prices of local food which had offset the falling in prices of Tongan kava and Tongan tobacco by 6.1 percent and 2.2 percent. Inflation expects to remain well below the inflation reference target rate of 5 percent in 2019/20 financial year. The outlook for the medium-term is projected to be stable with risks on the downside. The downturn in global growth posed threats on inflation.



3. In 2019/20 financial year, fiscal policies were geared towards Government nine (9) priority areas, mainly on Public Sector Reform (an approximate of 34 percent of the approved estimate), aimed to maintain balanced fiscal position over the medium term. As such, continuous prudent in Government spending and an ongoing monitoring the set fiscal anchors to ensure sufficient funding is available for the delivery of core services. The delays in the implementation of TOP\$200 excise tax charged per kilogram (kg) on locally manufactured Tapaka Tonga products expect to have impacts on the revenue collection. COVID-19 anticipated to affect both the domestic revenue collection and planned expenditures. It is critical that Government should continue to carefully manage fiscal stance in view of: (i) the timeline to start repayment of the China loan; (ii) the Tongan economy highly vulnerable to external shocks, natural disasters, other global factors and exposed to foreign currency risks; (iii) possible fiscal deficit position ahead, as well as (iv) to manage any potential instability.

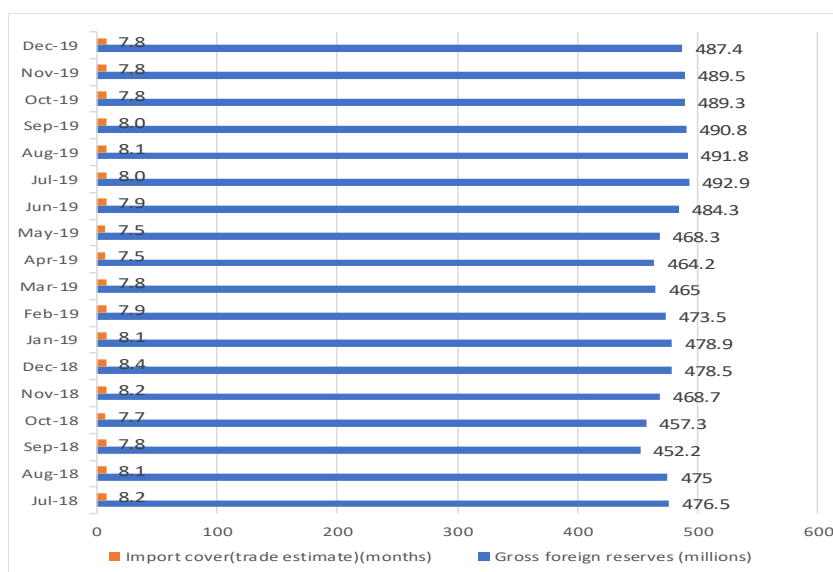
4. The monetary policy stance has been remained in same accommodative effort to support growth. Net domestic credit growth grew at soft rate since the past 12 months (4 quarters) up to September 2019. This slight increase was due to the increase in domestic credit to Private Sector for the period. The average lending for the last six (6) months, June 2019 Quarter, up to the September 2019 Quarter, slightly maintained at \$347

million compared to \$346 million in 2018. The total liquidity at the end of September 2019 recorded at \$523 million compared to \$531 million recorded at the end of the same period in 2018.

5. Foreign Reserves remained high above \$460 million at \$487.4 million at the end-December 2019 relative to the end-December 2018 (\$478.5 million), equivalent to cover 7.8 months of import (trade estimate).

The balance of trade (OET basis) deficit is expected to remain at 3.1 percent of GDP in 2019/20, while the external position still remained strong with net international reserves of 7.5 months of import (trade estimate)

Graph 2: Foreign Reserve v.s. Import Cover (trade estimate)



Source: National Reserve Bank of Tonga

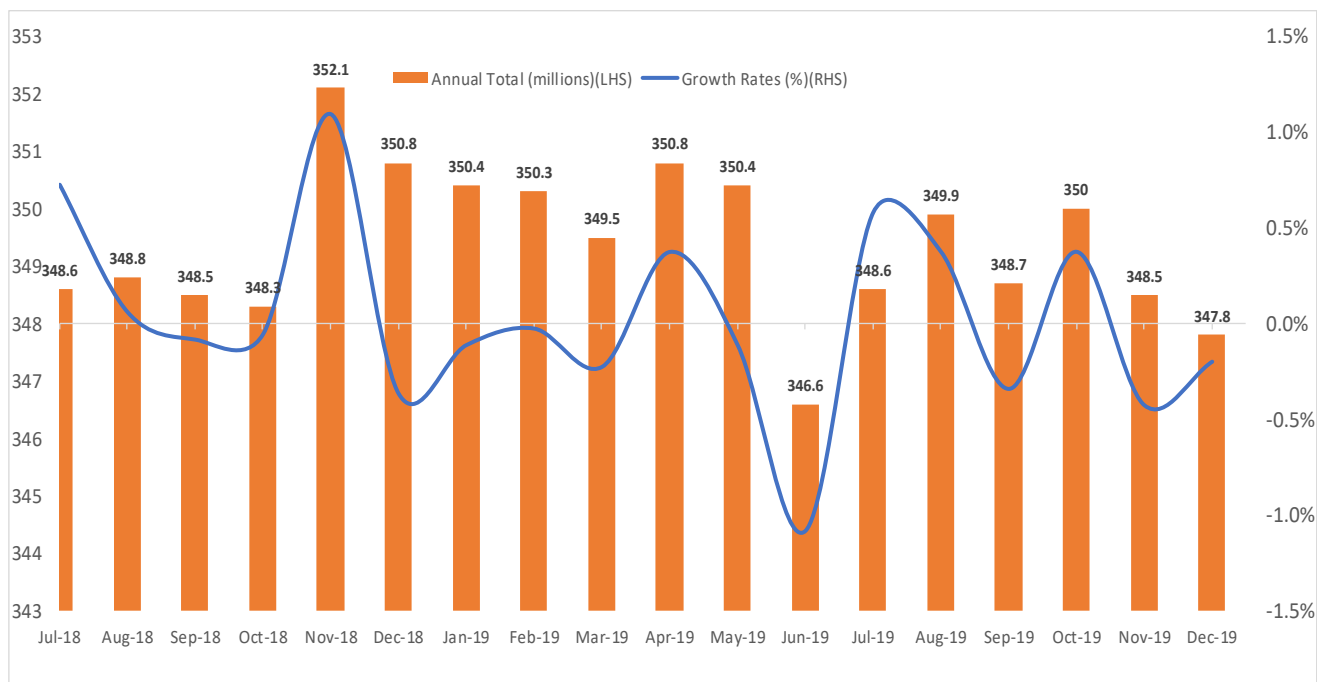
6. Remittances is expected to decline at an average of \$348.9 million by the end of the reviews period from an average of \$349.5 million in compared to the same period last year. Similarly, remittances had declined by 1.1 percent from 32.3 percent of GDP (end of December 2018) compared to 31.2 percent of GDP at the end of this reviewed period.

On 12 months average up to September 2019, indicated:

- (i) That 90.6 percent of the remittances were due to *Private Transfers*. This reflected the receipts of family support from friends and relatives abroad supporting domestic demand.
- (ii) An average of 6.8 percent was due to *Employee Compensation* in which this reflect the sum of wages and salaries from the seasonal workers abroad, Tongan residents working short term overseas and resident employees serving foreign organisations.
- (iii) An average of 2.1 percent was for *Private Capital Transfers* mainly for private grants on investment projects (particularly for construction purposes by families). However, insignificant amount of remittances was due to *Social Benefits*.

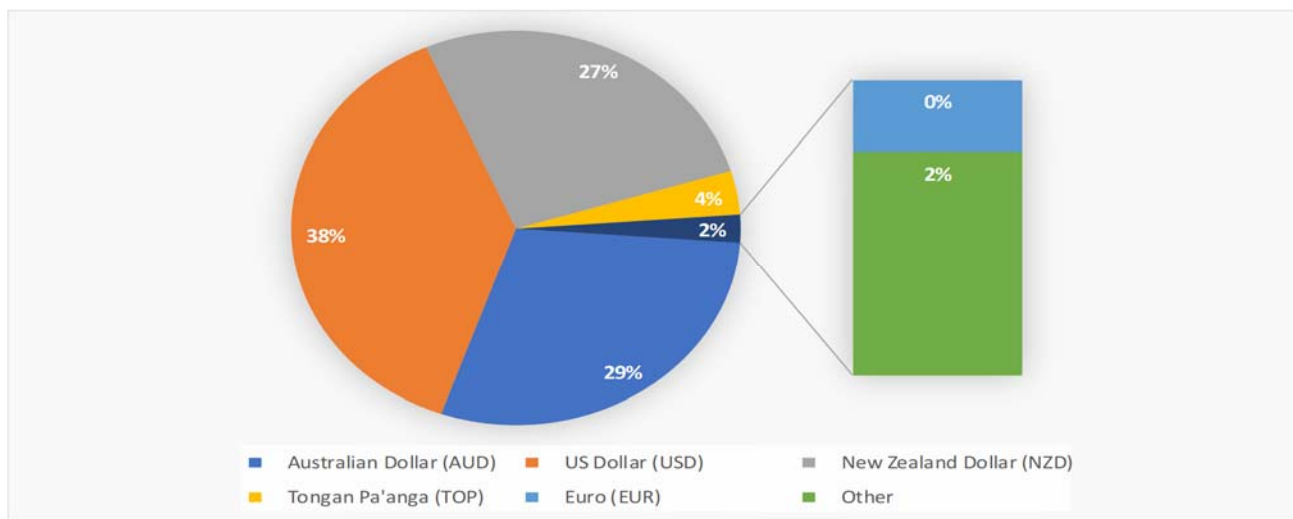
In terms of Currency, remittances were led by US dollar (USD) by 38 percent, closely followed by Australian dollar (AUD) by 29 percent and then New Zealand dollar (NZD) by 27 percent. The remaining currencies were Tongan Pa'anga (TOP), Euro (EUR) and Other, in which they were all below the average of 5 percent for 12 months average up to September 2019.

Graph 3: Remittances (Annual Total)



Source: National Reserve Bank of Tonga

Graph 4: Remittances by Currency (12 months average)



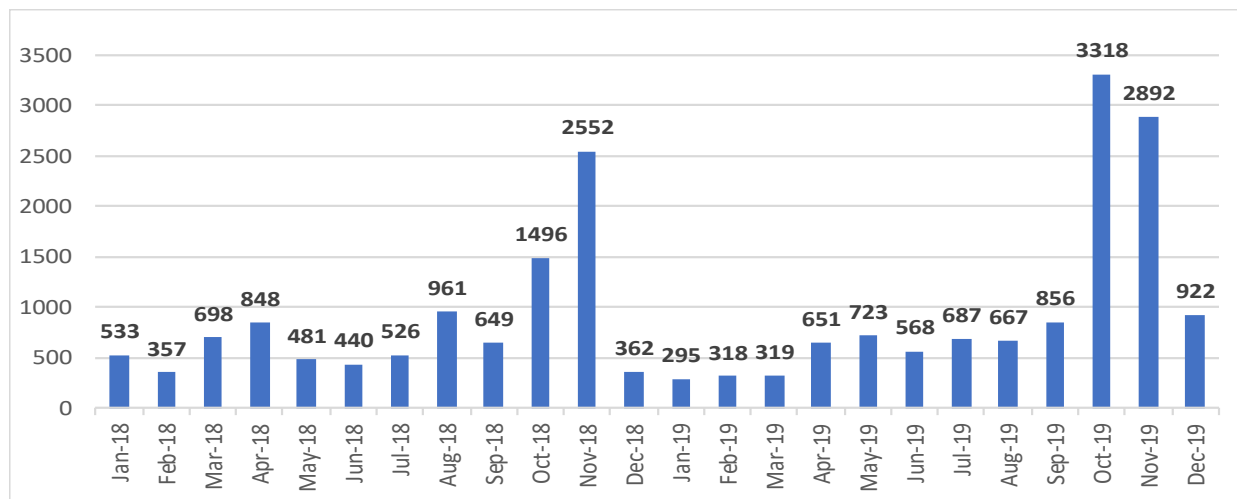
Source: National Reserve Bank of Tonga

Economic Growth and Real Sector

- Agricultural and Forestry sector real growth has slowly recovered during the first half of 2019/2.** This was shown by the 12-months actuals of the total agricultural exports in Graph 5. In terms of metric tonnes; (i) Squash was the top leading exports, increased by 66 percent in compared to the revised period of last year. (ii)

root crops increased by 26 percent in compared to the revised period of last year, 75 percent of this increase was stemmed from cassava exports. Similar stories revealed from the rest of the export groups however Yam exports declined in the reviewed period (2018 compared to 2019) as well as in 12 months terms up to December 2019. The export of brown coconuts showed a slow recovery from the last reviewed period, however, not sufficient enough to cover the decline in terms of 12 months of December 2019 compared to 2018.

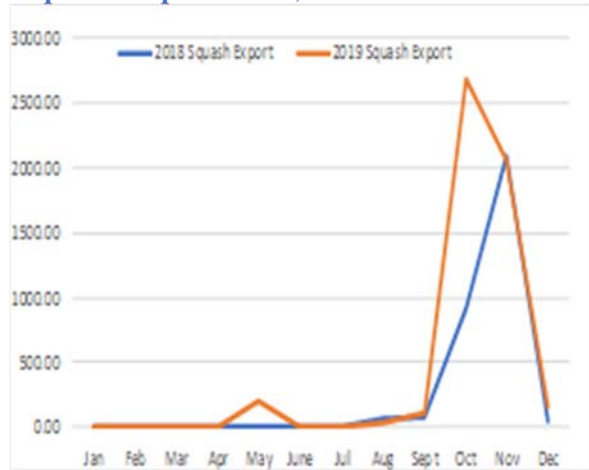
Graph 5: Total Monthly Agricultural Export (metric tonnes)



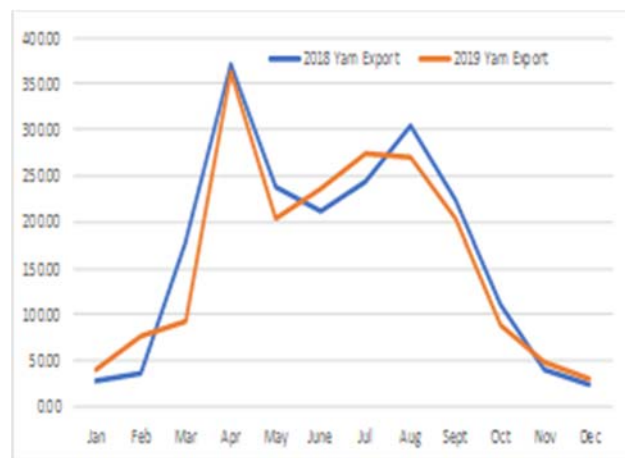
Source: Ministry of Agriculture Food and Forest (Quarantine)

Graph 6: Agricultural Exports (12 months) (metric tonnes)

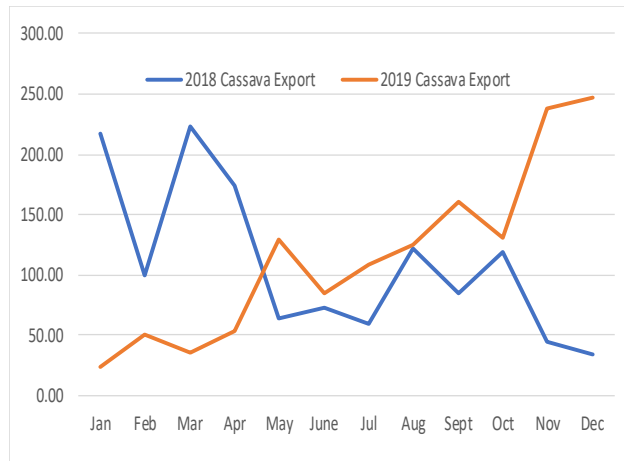
Export of Squash 2018, 2019



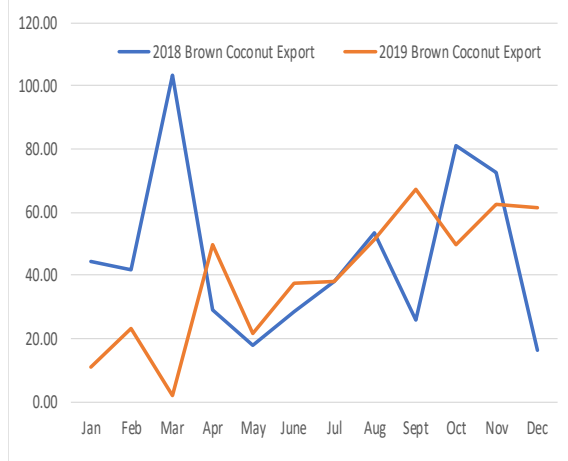
Export of Yam 2018, 2019



Export of Cassava 2018, 2019



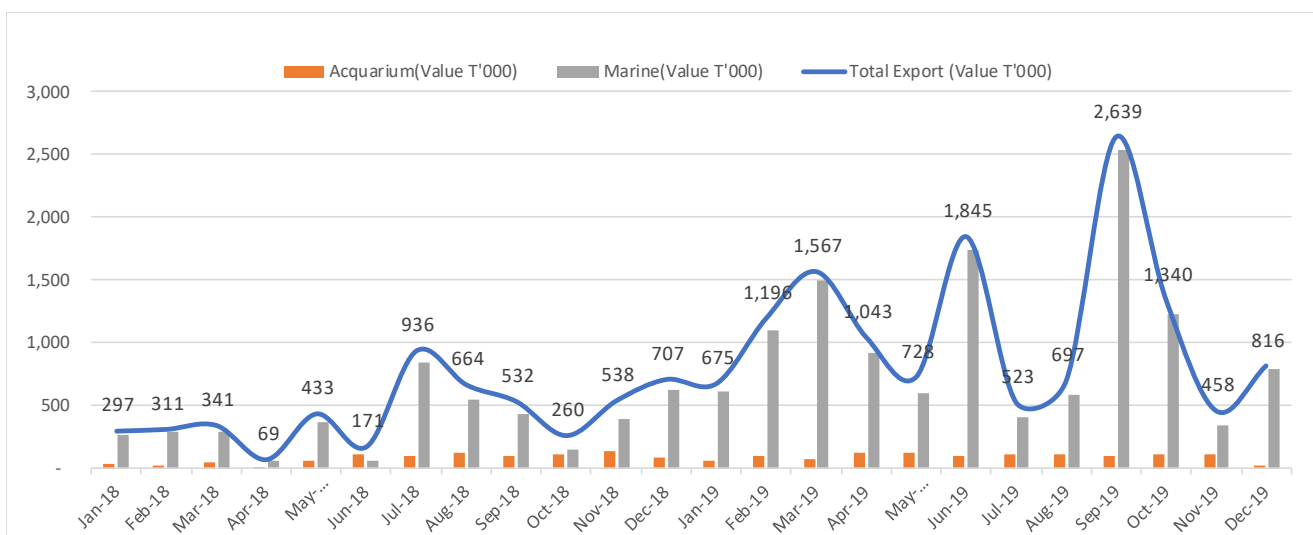
Export of Brown Coconuts 2018, 2019



Source: Ministry of Agriculture Food and Forest (Quarantine)

8. **Fishing sector performance for the current period recorded great improvement in compared to the same period of last year, FY 2018/19.** The revised forecast for the period reported a spike in fisheries total value of export by 78 percent compared to its performance at the same period in 2018. The positive performance in the sector was stemmed from an improved export of Marine species, which was increased by 9 percent from 2018 to 91 percent of the forecast period. The exports of Tuna increased by 98 percent in compared to the same period of last year also contributed to the sector’s positive performance. On the other hand, Aquarium exports value declined by 12 percent in compared to the same time last year, attributed to the declined in values of exporting corals (both soft and live hard).

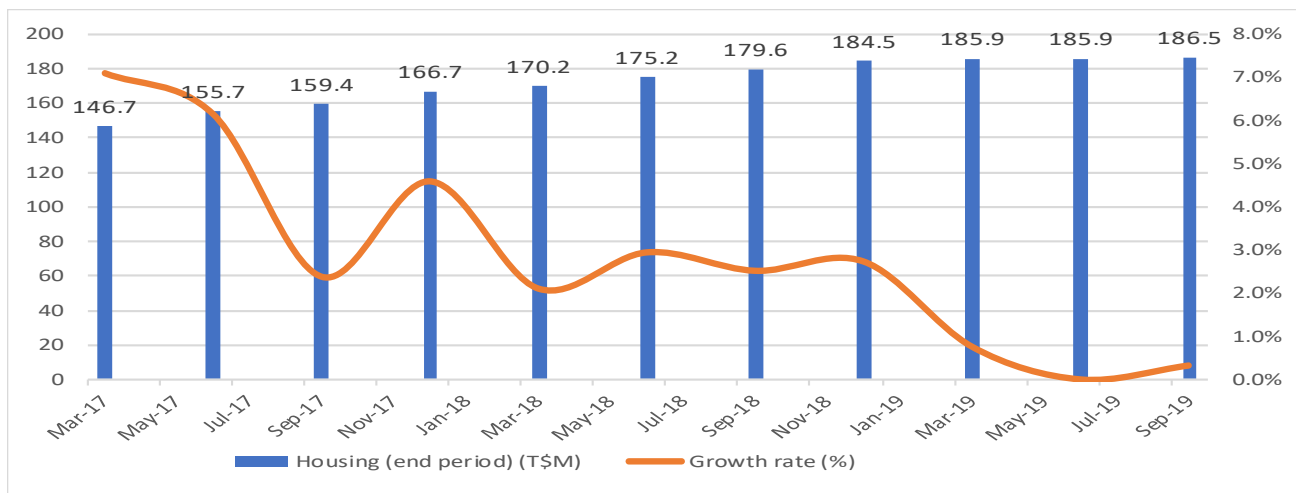
Graph 7: Total Monthly Fisheries Exports (T'000)



Source: Ministry of Fisheries

9. **Construction sector continued to dominate the economic activity in the first half of 2019/20 financial year.** The graph below, depicted the Financial lending had continued to grow but at a decreasing rate. The donor funded projects include the recovery activities following TC Gita kicked start during the reported period, however, were again on hold due to the COVID-19 pandemic. The close down of border due to the pandemic contributed to the downward revision of the growth forecast for 2019/20.

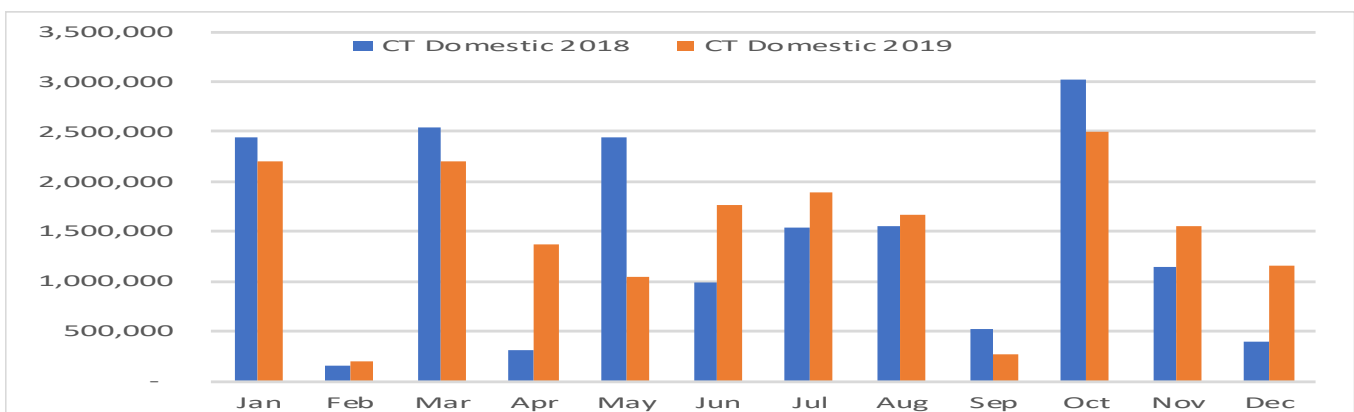
Graph 8: House Loan from Financial Institutions (Quarterly) (T\$M)



Source: National Reserve Bank of Tonga

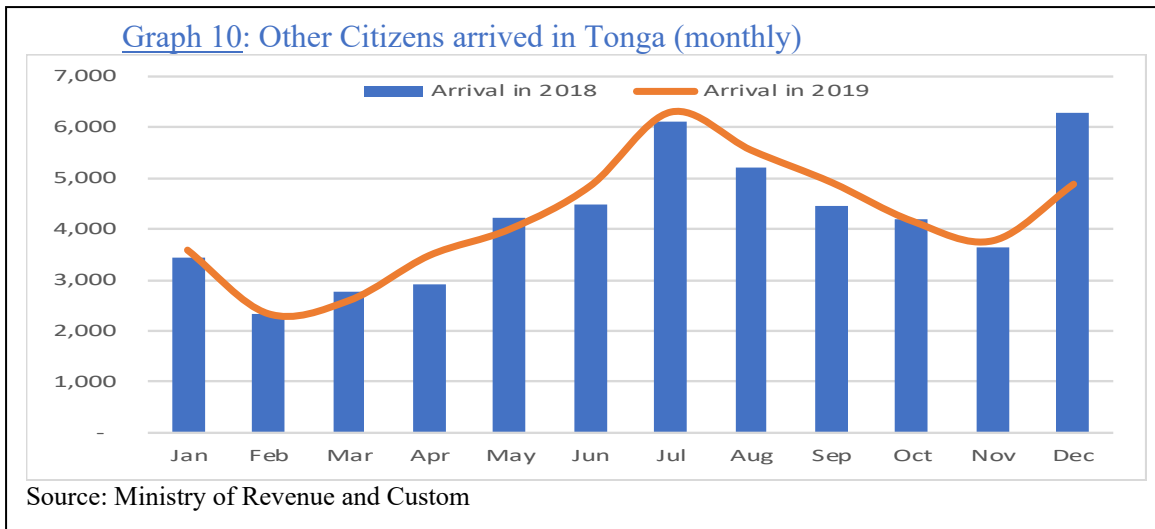
10. **Slight picked-up in wholesale and retail sector for the reviewed period 2019/20.** The Wholesale and retail growth performance indicated a significant improvement by 11 percent for the reviewed period compared to last year. This improved performance in the Jul-December 2019 had outweighed the slight declined in the sector’s performance reported during the first half of the year. On a twelve (12 months) term, reflected an improved performance by 4 percent in 2019 compared to 2018. This implied the sector’s slow recovery from the damages due to TC Gita.

Graph 9: Performance of Consumption



Source: Ministry of Revenue and Custom

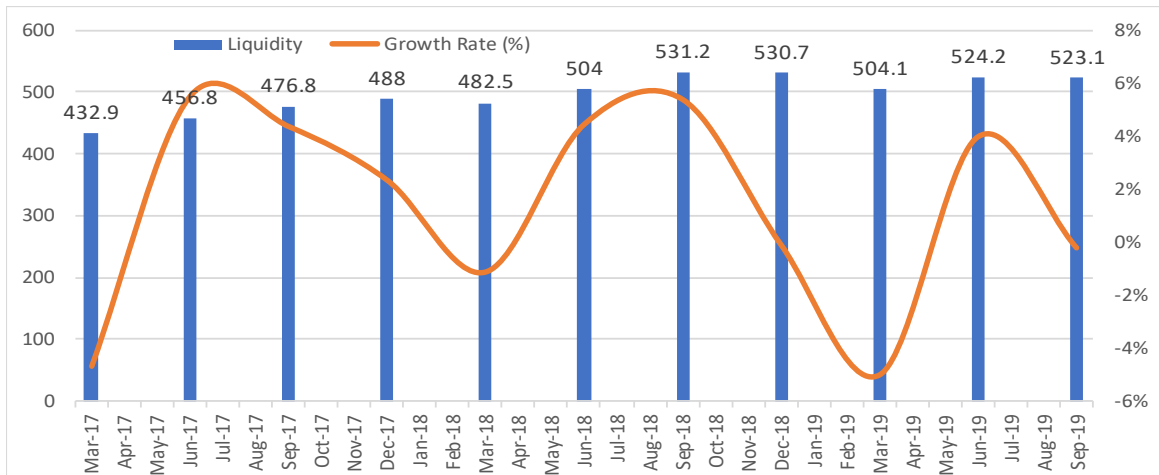
11. The Hotel and Restaurant sector maintained a positive growth despite the slight declined in the total numbers of other citizens visited the Kingdom during the first half of 2019/20 financial year. The total tourists arrived in Tonga during the period slightly declined by 1 percent compared to last year. This was mainly due to the declined in number of tourists visited Tonga in the months of September and October 2019. In contrast, the total tourist arrival on 12 months period increased by 1 percent compared to 2018. The total tourist arrival included Tongan with foreign passports.



12. Public Administrations remained stable though had significant contribution to the economy. Government service delivery continued to have positive impacts on the economy as total number of civil servants continued to rise attributed to the continued recruitment in the civil service.

13. The liquidity remained strong despite the slowdown in growth rate at the first half of the 2019/20 financial year. The total liquidity position remained positive although grew at a diminishing rate after the last quarter of 2018/19 financial year, slightly above the average of \$522.6 million for the 12 months period towards the end of September 2019. This implied the banking activities remained healthy, attributed to increase in withdrawals by the Commercial Banks from the Reserve Banks vault lowered the Exchange Settlement Account (ESA), thus implied a slight decline in liquidity in the September quarter of 2019.

Graph 11: Total Liquidity (Quarterly ended) (\$M)

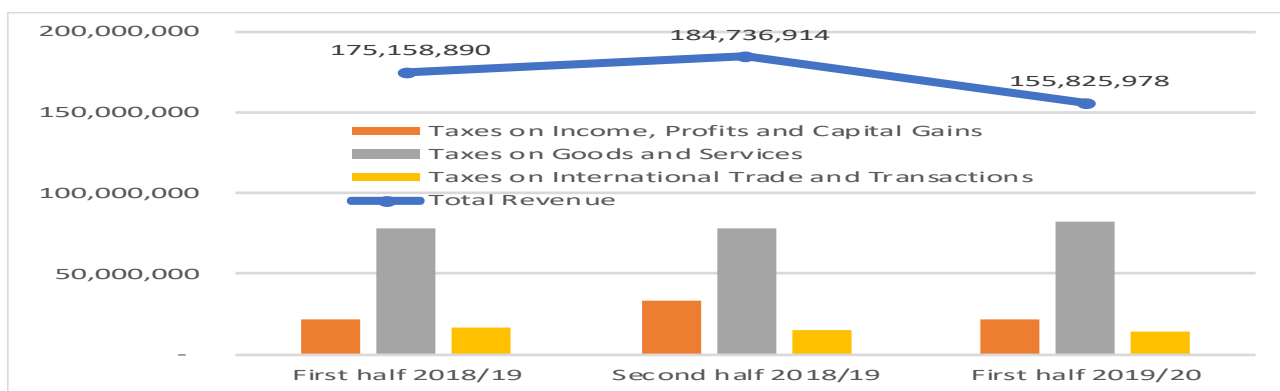


Source: National Reserve Bank of Tonga

Fiscal Sector

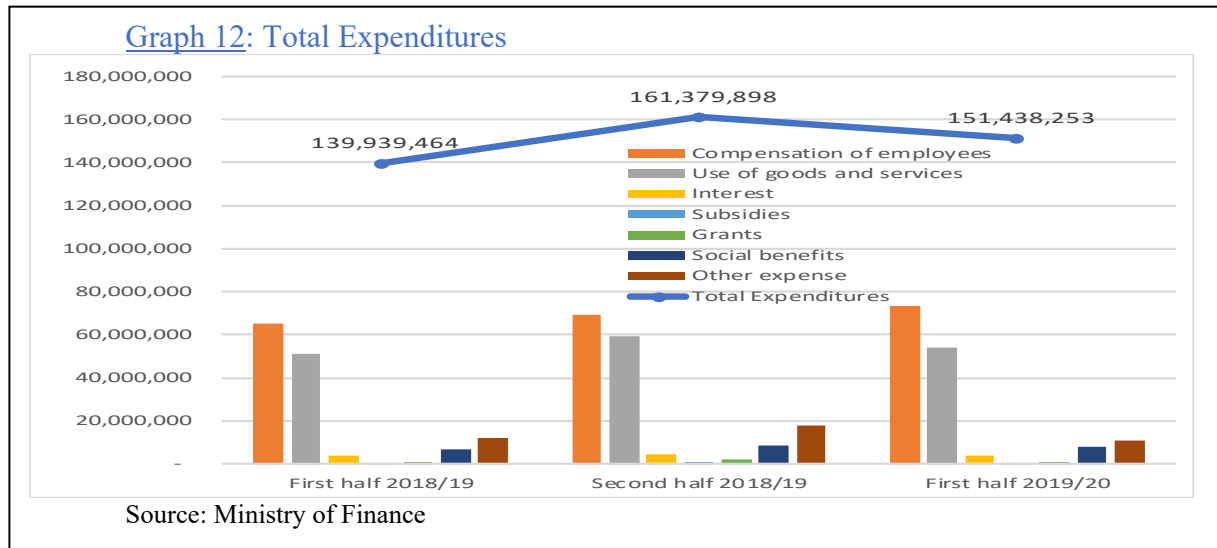
14. Government presented a fiscal deficit of \$4.38 million for the first half of the 2019/20 financial year, compared to \$14.79 million surplus and \$32.09 million surplus in the previous six months and the first half of 2018/19 respectively.
15. Total Revenue in the first half of 2019/20 financial year was lower than the first half of the 2018/19 financial year. This was due to the huge decline in Grant from International Organizations by 57 percent, mainly from the World Bank/ International Development Agency (IDA) and European Union. The domestic revenue reported an improvement in collection by 4 percent for the reviewed period. This was due to the increased from Taxes on Goods and Services and Other Revenue. On the other hand, Taxes on International trade and transactions recorded a fall, by 13 percent and a higher portion in compared to the first and second half of 2018/19 financial year. The decline was due mainly from the decreased collection on Business Import Duties driven by the on-going TC Gita recovery program for Tonga.

Graph 12: Tax Revenue

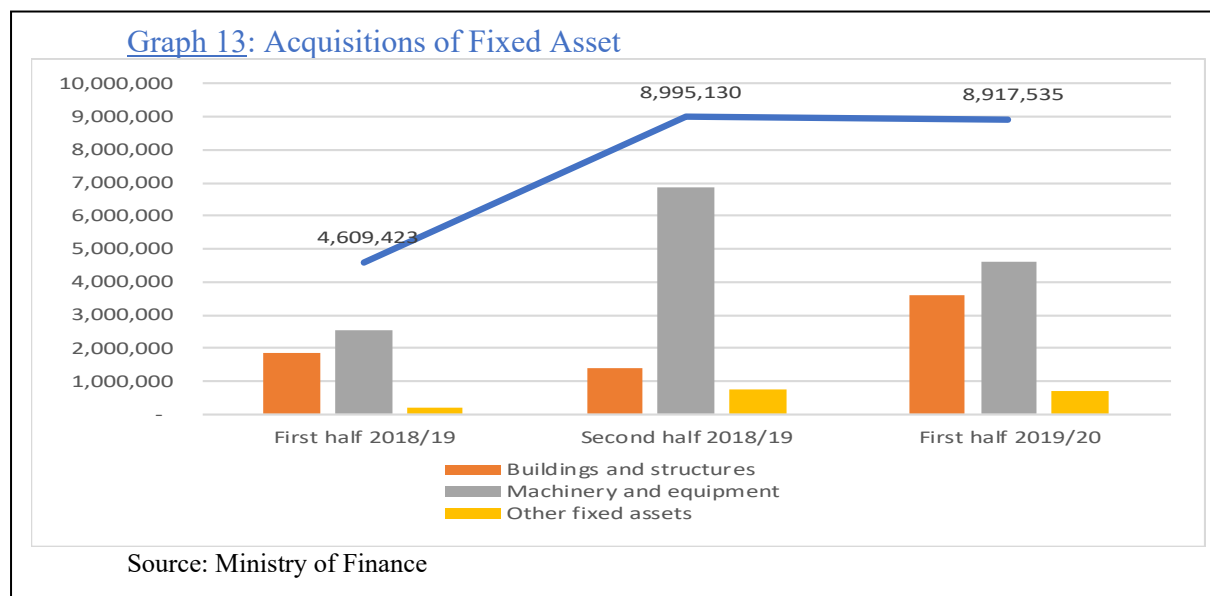


Source: Ministry of Revenue and Custom & Ministry of Finance

16. Government expenses increased by 8 percent in the reviewed period compared to the same period in 2018/19. This was largely due to increase in; (i) compensation of employees, and the (ii) use of goods and services expenditures. The Compensation of Employees expenditures increased by 12 percent, was largely from the increased spending on contract labours, salaries and overtime payments. The use of goods and services expenditures increased by 6 percent, attributed to the increased spending on road maintenance, construction and purchasing of technical equipment. Alternatively, the total expenditures declined by 6 percent compared to the Second half of 2018/19, the increase in the compensation of employees was offset by the large decline in spending on Other expenditures and Using of goods and services.



17. Acquisition of fixed assets (capital spending) increased significantly at the first half of 2019/20 by 93 percent to \$8.9 million compared to the first half of 2018/19. This was largely due to increase in acquisitions of (i) machinery and equipment by 81 percent and (ii) building and structures by 95 percent. This reflect the implementation of the reconstruction of shelter and classrooms for those who were affected by TC Gita during the review period. The acquisition of fixed assets slightly declined by 1 percent against the second half of 2018/19 financial year.



18. Debt service on both domestic and foreign loan continued. Government paid a bond of \$5 million, matured in July 2019. Government had serviced the Principal repayment of \$3 million for external loan include the Tonga National Road Improvement Project (TNRIP).

19. Potential Risks: The major potential risks on the Tongan economy over the medium term include the followings:

Economic risks:

- COVID-19 pandemic posed threats on growth and remittances, trade related activities and tourism, Government fiscal position;
- Potential drainage of government reserves.

Natural disaster and climate change:

Tonga as the second most vulnerable country in the world to the impacts of natural disasters and climate change, poses as an ongoing risk to growth and development efforts.

Financial risk:

A potential risk to the stability of financial sector would be the acceleration of credit growth. It is noted that the financial sector will be greatly impacted by COVID-19.

Health risk:

NCD remains a high risk. In view of the global health emergency (COVID-19), those with conditions including NCDs are vulnerable to COVID-19

