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CONFIDENTIAL

October 17, 1988

To: Members of the Executive Board
From: The Secretary
Subject: Tonga - Real Effective Exchange Rate - Information Notice

Attached for the information of the Executive Directors is an information notice on the real effective exchange rate of the pa'anga.

Mr. Acquah (ext. 8661) is available to answer technical or factual questions relating to this paper.

Att: (1)

INTERNATIONAL MONETARY FUND

TONGA

Real Effective Exchange Rate - Information Notice

Prepared by the Asian Department and the
Exchange and Trade Relations Department

(In consultation with the Legal Department
and the Research Department)

Approved by Douglas A. Scott and H. B. Junz

October 17, 1988

The recent evolution of Tonga's real effective exchange rate, as measured by the standard index developed in connection with the information notice system, is set out in the attached table and chart. Based on this index, as of June 1988, the pa'anga had appreciated in real effective terms by 12.7 percent since the last occasion on which the Executive Board was informed of Tonga's exchange rate developments--the 1987 Article IV consultation in November 1987 (SM/87/253, 11/2/87). The nominal effective appreciation over the same period was 11.1 percent.

The real effective appreciation between November 1987 and June 1988 mainly reflects the appreciation of the Australian dollar, to which the pa'anga is pegged at par, vis-à-vis the currencies of Tonga's major trading partners. Over the same period, consumer prices in Tonga 1/ relative to those of trading partners rose by 1.5 percent, also contributing to the real effective appreciation.

The Acting Chairman's summing up of the discussions of the Executive Board during the 1987 Article IV consultation (SUR/87/114, 11/25/87) noted that reviewing the fixed link with the Australian dollar would give scope for greater flexibility in exchange rate policy, and would facilitate reducing price fluctuations in Tonga and strengthen competitiveness. In the course of the interim Article IV consultation discussions held during August 25-September 6, 1988, the appropriateness of the present system of pegging the pa'anga at par to the Australian dollar was discussed with the authorities. Given Tonga's narrow export base, and its heavy reliance on private transfers and concessional aid, the authorities recognized the vulnerability of the external position. Preliminary data indicate some deterioration in the balance of payments in 1987/88 (fiscal year ending June 30), owing partly to a drought that

1/ Tonga's consumer price index is published only on a quarterly basis; the second quarter of 1988 is the latest quarter for which actual data are available.

reduced agricultural exports, but also to sustained import growth and a fall in workers' remittances. The authorities envisage a more active role for exchange rate policy following the establishment of a central bank, which is expected to become operational in March 1989.

A full discussion of external developments and prospects, as well as exchange rate policy, will be contained in the 1988 staff report on the interim Article IV consultation discussions, to be issued in early November.

Table 1. Tonga: Real Effective Exchange Rate and Related Series

(Indices: 1980 = 100)

	Real Effective Exchange Rate <u>1/</u> <u>2/</u>	Nominal Effective Exchange Rate <u>1/</u>	Relative Consumer Prices (Local Currencies)	Exchange Rate in Terms of U.S. Dollars <u>1/</u>	Consumer Price Index (Seasonally Adjusted) <u>3/</u>	Consumer Price Index (Not Seasonally Adjusted)
Quarterly						
1982						
II	118.4	111.5	106.2	92.0	128.2	127.6
III	115.2	109.2	105.6	86.3	130.3	130.8
IV	110.9	107.7	103.0	83.5	128.0	129.2
1983						
I	111.5	106.9	104.4	82.9	132.5	131.5
II	109.0	103.2	105.6	76.7	133.9	132.7
III	119.5	106.2	112.6	77.3	147.8	148.7
IV	120.9	109.8	110.2	79.8	144.8	146.5
1984						
I	119.2	112.5	106.0	81.7	140.5	139.6
II	115.4	110.8	104.1	79.3	140.5	138.4
III	116.1	114.8	101.2	73.5	138.0	138.9
IV	121.7	120.1	101.3	74.2	140.8	143.1
1985						
I	117.6	113.4	103.8	65.9	147.7	147.0
II	108.6	100.3	108.3	58.5	157.3	154.2
III	115.0	97.7	117.8	61.2	174.9	176.0
IV	114.9	91.6	125.6	60.3	188.6	192.4
1986						
I	120.9	92.3	131.1	61.6	200.1	199.4
II	119.4	90.3	132.2	62.6	202.5	197.6
III	107.6	81.4	132.2	54.6	206.5	207.6
IV	107.8	84.1	128.2	56.8	205.4	210.1
1987						
I	103.6	82.6	125.5	58.9	203.6	203.2
II	106.0	84.2	125.9	62.7	207.4	201.9
III	109.0	84.6	128.8	62.7	215.3	216.2
IV	107.2	80.6	133.1	61.8	226.1	231.5
1988						
I	109.4	80.3	136.4	63.2	235.1	234.9
II	115.8	85.0	136.4	68.3	239.5	232.8
Monthly						
1987						
Nov. <u>4/</u>	105.6	79.3	133.2	60.3	226.1	
Dec.	106.7	79.5	134.4	62.4	229.0	
1988						
Jan.	107.7	79.4	135.7	62.5	232.0	
Feb.	109.5	80.2	136.6	62.7	235.1	
Mar.	111.2	81.3	136.9	64.3	236.5	
Apr.	112.8	82.4	136.9	65.6	238.0	
May	115.8	84.5	137.0	68.3	239.5	
Jun.	119.0	88.1	135.2	71.0	237.6	
Percentage change						
Jan. 1988- June 1988	12.7	11.1	1.5	17.7	5.1	

Source: Information Notice System.

1/ Increases mean appreciation.

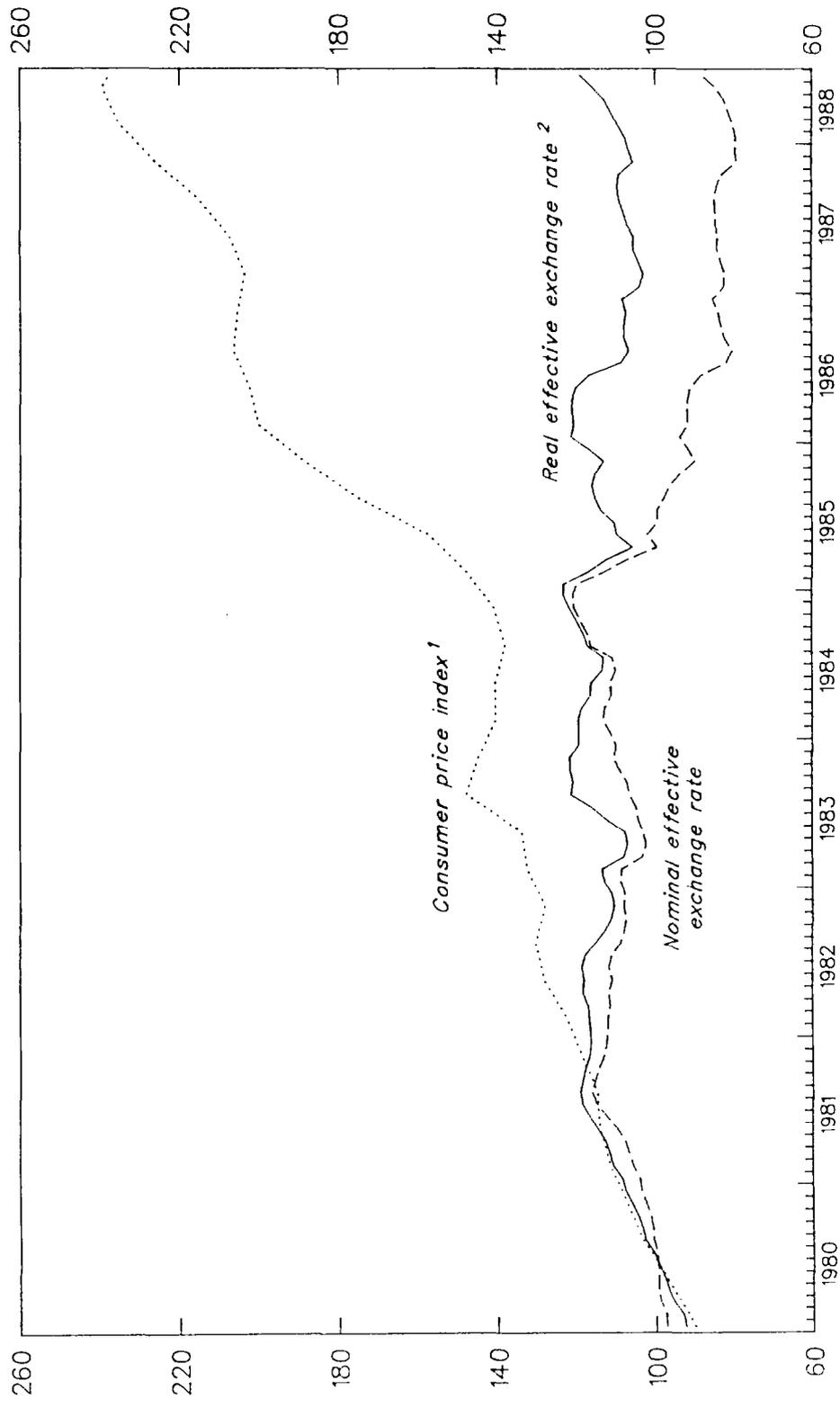
2/ Using seasonally adjusted price indices.

3/ Monthly consumer price data for Tonga are derived by the Fund staff from the official statistics which are only collected quarterly.

4/ Date of latest consideration by Executive Board.



CHART
 TONGA
 INFORMATION NOTICE SYSTEM INDEX OF REAL EFFECTIVE EXCHANGE RATE
 (1980=100)



Source: Information Notice System.
¹ Seasonally adjusted.
² Trade-weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices, increases mean appreciation.

