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CONFIDENTIAL

June 24, 1987

To: Members of the Executive Board
From: The Acting 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 Tongan pa'anga.

Mr. Bélanger (ext. 8671) 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 and the Exchange and Trade
Relations Departments

(In consultation with the Legal and Research Departments)

Approved by P.R. Narvekar and H.B. Junz

June 22, 1987

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. By March 1987, the Tongan pa'anga had depreciated by more than 10 percent, on the basis of the standard index, since the last occasion on which the Executive Board had an opportunity to discuss Tonga's exchange rate policy--the 1986 Article IV consultation in May 1986. 1/

The pa'anga has been pegged at par to the Australian dollar since November 1976. In real effective terms, the pa'anga depreciated by 14.4 percent during the year to March 1987, fully reversing the appreciation that had taken place since April 1985. To a large extent, the depreciation of the pa'anga is attributable to movements in nominal exchange rates. In the year to March 1987, the pa'anga depreciated by 9.3 percent in nominal effective terms, while the foreign rate of inflation (as computed within the Information Notice System) exceeded domestic inflation by 5.6 percentage points. The strengthening of the Australian dollar since March 1987 has likely been reflected in a slight appreciation of the pa'anga in real effective terms.

During the 1986 Article IV consultation discussions, the staff projected a moderate balance of payments surplus for the fiscal year 1985/86 (July-June), but envisaged a worsening of the balance of payments situation over the medium term. No information on the balance of payments or movements in official reserves has since become available to the staff.

1/ Chairman's summing up circulated as SUR/86/44 (5/21/86).

Staff Appraisal

The real effective depreciation of the pa'anga during the year to March 1987, which follows an appreciation of similar magnitude, is largely attributable to the system of pegging the pa'anga to the Australian dollar. At the time of the 1986 Article IV consultation, the staff concluded that policies in a broad range of areas were required to support the authorities' objectives of broadening the productive base and strengthening the balance of payments over the medium term. The recent depreciation of the pa'anga in real effective terms should help promote the achievement of these objectives.

During the 1986 Article IV consultation discussions, the authorities expressed their intention to review the appropriateness of the exchange rate system following modification of commitments to reimburse the Bank of Tonga for foreign exchange losses, an intention that was welcomed by Executive Directors. The staff understands that the commitments with the Bank of Tonga have been terminated, and the forthcoming establishment of the Central Bank of Tonga may provide the occasion for the review of the exchange system.

According to the cycle specified during the previous consultation, the 1987 Article IV consultation with Tonga should be concluded by November 21, 1987. It was proposed in "Consultation Procedures--Initiation of the Bicyclic Procedure and Proposed Changes in Cycles for Article IV Consultations" (SM/87/117, 5/20/87), that a bicyclic procedure be adopted for Tonga.

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)	Consumer Price Index (Not Seasonally Adjusted)
Quarterly						
1982						
I	117.0	111.9	104.6	95.4	122.7	121.8
II	118.5	111.5	106.3	92.0	128.3	127.6
III	115.1	109.2	105.5	86.3	130.1	130.8
IV	110.9	107.7	103.0	83.5	128.0	129.2
1983						
I	111.6	106.9	104.5	82.9	132.6	131.5
II	108.8	103.2	105.5	76.7	133.9	132.7
III	117.7	106.2	110.9	77.3	144.9	146.0
IV	120.4	109.8	109.7	79.8	144.5	146.0
1984						
I	118.9	112.5	105.8	81.7	140.0	139.0
II	115.4	110.8	104.1	79.3	140.5	138.4
III	116.0	114.8	101.1	73.5	137.6	138.9
IV	121.8	120.1	101.4	74.2	141.0	143.0
1985						
I	117.9	113.4	104.1	65.9	148.0	147.0
II	108.5	100.3	108.2	58.5	157.2	154.2
III	114.7	97.7	117.5	61.2	174.2	175.9
IV	115.1	91.6	125.8	60.3	189.2	192.3
1986						
I	121.3	92.3	131.6	61.6	200.6	199.4
II	119.0	90.3	131.8	62.6	201.8	197.6
III	107.3	81.4	131.9	54.6	205.7	207.6
IV	108.2	84.1	128.7	56.8	206.4	210.1
1987						
I	103.9	82.6	125.9	58.9	204.5	203.3
Monthly						
1986						
May <u>3/</u>	119.8	91.0	131.7	63.8	201.8	...
June	116.3	88.2	131.9	60.5	203.1	...
July	108.1	81.8	132.2	55.5	204.4	...
Aug.	106.2	80.3	132.3	53.7	205.7	...
Sep.	107.7	82.3	131.0	54.5	205.9	...
Oct.	107.9	83.1	129.9	56.0	206.2	...
Nov.	107.8	83.9	128.6	56.6	206.4	...
Dec.	108.8	85.3	127.7	57.9	205.8	...
1987						
Jan.	104.5	82.4	126.8	57.9	205.1	...
Feb.	103.4	82.1	125.9	58.5	204.5	...
Mar.	103.8	83.2	124.9	60.3	204.2	...
Percentage change						
May 1986- Mar. 1987	-13.3	-8.6	-5.2	-5.5	1.2	

Source: Information Notice System.

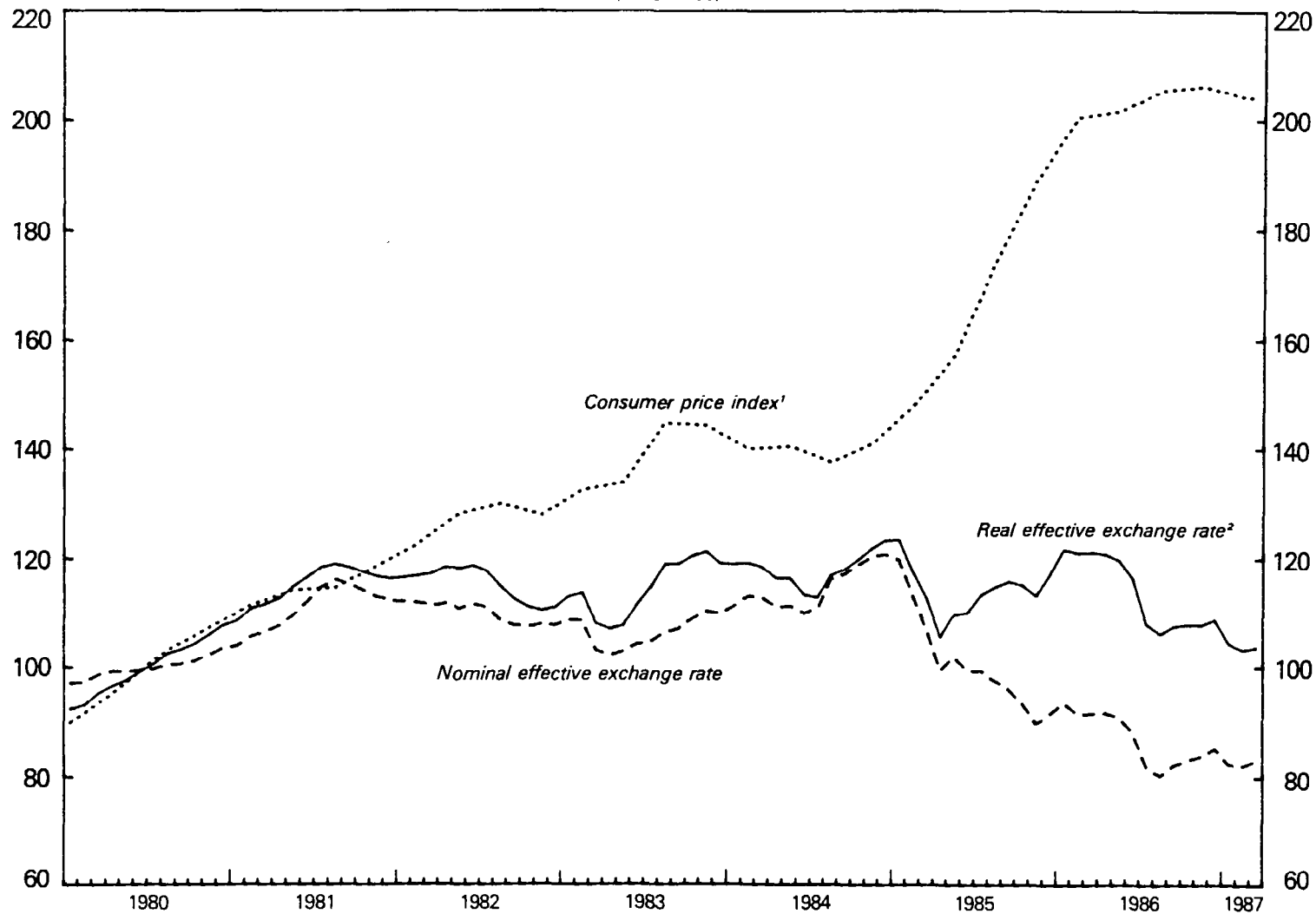
1/ Increases mean appreciation.

2/ Using seasonally adjusted price indices.

3/ Date of latest consideration by Executive Board.

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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.

