



NATIONAL RESERVE BANK OF TONGA

MONTHLY ECONOMIC REVIEW

Vol. 7

No. 12

Month Ended: December 2020

Global projections hopeful for recovery in 2021

The International Monetary Fund (IMF), in its January 2021 World Economic Outlook (WEO), expects the global economy to recover by 5.5% growth in 2021 (revised upwards from the previous projection of 5.2%). The recovery of major economies, particularly the US, Japan, and China, towards the end of 2020, was supported by sizeable fiscal policy measures and COVID-19 containment efforts. Advanced economies are forecasted to rise by 4.3% in 2021 as business activities resume more actively and the distribution of COVID-19 vaccines. Meanwhile, US economic growth increased at an annual rate of 4.0% in December 2020, driven mainly by the rise in exports, investments, and consumption. The Reserve Bank of Australia anticipates a 5.0% growth in 2021 as businesses continue with recovery efforts and lower unemployment rates in December 2020. In New Zealand, labour market conditions recovered in the December 2020 quarter as the employment rate rose by 0.4% from the previous quarter.

Some improved outcomes for domestic activities

The primary sector showed mixed performances in December 2020. Agricultural export volumes continued to decline over the month by 67.6 tonnes (6.3%) due to lower exports of squash and watermelons. Squash exports declined over the month by 116.9 tonnes (39.1%) and over the year by 4,011.7 tonnes (78.0%). Watermelon exports also fell by 23.8 tonnes (50.7%) in December 2020, coinciding with further exporting mishaps during the month. However, proceeds for agricultural and marine exports both increased by \$0.03 million (4.4%) and \$0.1 million (32.8%) respectively over the month.

The industry sector recorded mostly positive movements in December 2020. More new classroom buildings were reconstructed to meet cyclone resilient standards under the Pacific Resilience Program (PREP) project, which aligns with the business construction loans increasing by \$0.4 million (2.0%) over the month and \$9.8 million (90.9%) annually. Additionally, new individual housing loans increased by \$0.9 million (5.9%), coinciding with the higher import payments for construction materials. Meanwhile, the upgrade of Lose 'o Pema road at Vava'u was completed and further supported growth in mining and quarrying.

The services sector remained subdued in December 2020. Total air arrivals reached their lowest for the year, decreasing by 87,331 passengers (80.5%) annually, coinciding with a \$91.8 million (67.8%) decline in travel receipts. Additionally, container registrations declined by 86 registrations (7.1%) over the month, driven by lower business containers. Consumption activities, however, is expected to pick up inline with the Christmas festivities and end of year functions.

Employment conditions remains weak

While Tonga continues to close its borders, the tourism sector remains mostly inactive. This gives rise to unemployment, especially those who are informally employed in the services sector. According to the 2018 Labour Force Survey, around 77.9% of the total labour force are informally employed. Meanwhile, the Government continues to provide temporary relief for employees affected by the COVID-19 pandemic through its fiscal stimulus package. The Reserve Bank's survey on job advertisements showed that job vacancies advertised continued to decline in December 2020.

Annual headline inflation recovers to positive growth

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Dec-20	Nov-20	Dec-20	Dec-19
Headline Inflation (%)	1.3	0.3	0.3	1.2
Domestic prices	2.1	0.7	-0.7	0.1
Imported prices	0.6	0.0	1.2	2.1

Source: Statistics Department

Both the local and imported prices rose over the month. Local prices rose driven by higher food items, specifically for marine foods, vegetables, electricity, gas & other fuels. Meanwhile,

higher imported prices attributed to the rise in food items. The appreciation of the NZD and AUD against the

Table 2: Average annual prices of selected items

Items (\$ per kg)	Unit	Dec-20	Annual	
			Dec-19	Change
Domestic				
Kava	1kg	\$60.00	\$92.50	-\$32.50
H/Cabbage	1kg	\$2.39	\$3.74	-\$1.35
Cockles (to'o)	1kg	\$6.43	\$7.69	-\$1.26
Yams - early	1kg	\$4.66	\$5.79	-\$1.13
Imported				
Pall Mall	1kg	\$23.00	\$19.29	\$3.71
Mutton Flaps	1 kg	\$17.68	\$16.44	\$1.24
Chicken pieces	1 kg	\$3.53	\$2.89	\$0.64

Source: Statistics Department

TOP may have contributed to higher imported prices for the month. Additional shipment fees during peak seasons on imports also contributes to higher imported inflation.

Annual inflation increased by 0.3% after recording consistent deflation rates since June 2020. Higher imported prices for food, tobacco and alcoholic beverages led the rise, whilst prices for local items such as electricity, gas & other fuels declined. Inflation is expected to gradually rise in the coming months driven by recovery of oil market prices.

Lower effective exchange rates in December

Table 3: Effective Exchange Rates

	Monthly			Annual	
	Dec-20	Nov-20	%	Dec-19	% Growth
Nominal Effective Exchange Rate Index	86.5	87.6	-1.6	91.5	-4.9
Real Effective Exchange Rate Index	99.7	101.1	-1.4	107.1	-6.1

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) declined again in December 2020 as major trading currencies appreciated against the Tongan Pa'anga (TOP) except for the USD. The USD weakened against the TOP following the US election in November 2020. The Real Effective



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Exchange Rate (REER) index also fell following the previous months' lower inflation rates.

In year ended terms, both the NEER and REER fell, indicating an improvement in Tonga's trade competitiveness with trading partners, supporting export proceeds and remittance receipts.

Foreign reserves at an all-time high for 2020

Table 5: Foreign Reserves

	Monthly			Annual	
	Dec-20	Nov-20	% Growth	Dec-20	% Growth
Foreign Reserves (\$ in million)	675.6	590.2	14.5	487.4	38.6
Import Coverage (months)	11.5	9.9	16.2	7.4	55.6

Source: National Reserve Bank Tonga

The foreign reserves increased significantly in December 2020 by \$85.4 million to \$675.6 million, underpinned by receipts of donor funds to support Tonga's recovery from Tropical Cyclone Harold, COVID-19, and remittances. This is equivalent to 11.5 months of imports. Similarly, the foreign reserves rose substantially over the year by \$188.2 million, attributed to receipts of budget support and official grants. The foreign reserves are held mostly in USD, AUD, and NZD.

Table 6: Remittance Receipts

	Monthly			Annual		
	Dec-20	Nov-20	% Growth	Dec-20	Dec-19	% Growth
Remittance (\$ in million)	43.8	37.0	18.3	398.0	348.1	14.3

Source: National Reserve Bank Tonga

Remittances increased in December 2020 by \$6.8 million to a new monthly record high of \$43.8 million, due mainly to higher receipts of family support and gifts, mostly NZD and USD receipts. Similarly, remittances rose by \$49.9 million over the year. This stemmed from higher private transfers and compensation of employees receipts.

Table 7: Overseas Exchange Transactions

	Monthly			Annual		
	Dec-20	Nov-20	% Growth	Dec-20	Dec-19	% Growth
Overall Balance	85.3	8.7	885.7	188.1	8.9	2004.8
Current Account	75.5	6.4	1276.4	158.3	-19.6	707.1
Merchandise Trade	-36.7	-35.5	-3.5	-410.9	-407.9	-0.8
Services	-4.3	2.5	-74.7	-0.5	24.1	-102.2
Income	3.1	2.4	32.4	17.4	5.0	247.1
Transfers	113.4	37.1	205.9	552.3	359.1	53.8
Capital Account	4.1	7.2	-42.8	39.7	38.0	4.2
Financial Account	5.7	-5.0	214.2	-9.8	-9.5	-3.4

Source: Banking Systems

Overall, Overseas Exchange Transactions (OET) recorded a higher surplus of \$85.3 million in December 2020, compared to the \$8.7 million surplus in the previous month. This was due to an increase in OET receipts, particularly from official transfers.

In the year to December 2020, the OET balance surplus increased substantially by \$179.2 million supported by the higher current account surplus. This attributed to higher official transfer receipts. The capital account also recorded a higher surplus underpinned by an increase in official

capital receipts. However, the financial account deficit widened over the year due mainly to interbank transfer payments.

Money supply continues to expand

Table 8: Broad Money

	Monthly			Annual	
	Dec-20	Nov-20	% Growth	Dec-19	% Growth
Broad money (\$ in million)	707.5	681.4	3.8	602.2	17.5
Net Foreign Asset	705.9	622.2	13.5	502.5	40.5
Net Domestic Asset	2.5	60.3	-95.8	100.4	-97.5

Source: Banking System, National Reserve Bank of Tonga

The strong growth in foreign reserves contributed to the expansion in broad money by \$26.1 million (3.8%) over the month and \$105.3 million (17.5%) over the year to December. Net domestic assets, on the other hand declined over the month and year as a result of higher government deposits from the receipts of government budget support and grants.

More Liquidity in the financial system

Table 9: Reserve money

	Monthly			Annual	
	Dec-20	Nov-20	% Growth	Dec-19	% Growth
Reserve money (\$ in million)	422.8	389.3	8.6	305.1	38.6

Source: Banking System, National Reserve Bank of Tonga

Liquidity increased over the month and year to December 2020 to \$422.8 million. The commercial banks' ESA (Exchange Settlement Account) rose the most, coinciding with the receipts of budget support and remittances. Currency in circulation also increased reflecting a more robust demand for cash during the December festivities. Required reserves also increased, coinciding with the rise in total deposits.

Lending to businesses and households slows down

Table 10: Total Lending

Lending	Monthly			Annual	
	Dec-20	Nov-20	% Growth	Dec-19	% Growth
Total Lending (\$ in million)	495.4	496.5	-0.2	500.9	-1.1
Business lending	236.3	237.3	-0.4	239.0	-1.1
Household lending	259.1	259.3	-0.04	261.8	-1.0
Other lending	0.0	0.0	0.0	0.1	0.0

Source: Banking System, National Reserve Bank of Tonga

After increasing for three consecutive months, the banks' total lending declined over the month and year to December 2020 as both businesses and household loans decreased. This was due to loan settlement and the usual loan run-off of outstanding loan balance. Lending to public enterprises and businesses in the trade, agricultural, and tourism sectors declined over the month as well as households' housing and vehicle loans. Similarly, over the year, loans were offered to households' for other purposes, public enterprises, and businesses within the trade, manufacturing and utilities sectors also declined.

In December 2020, the banks' total deposits hit a total of \$703.9 million, the first time for deposits to rise above \$700 million mark. This was due mainly to an increase of \$17.2 million (2.5%) in the month driven mainly by churches' time



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deposits and public enterprises and individuals demand deposits. The decline in total lending coupled with higher deposits, drove the loans to deposit ratio lower in December 2020 to 68.6% from 70.4% last month and below the 80% minimum.

Weighted average interest rate spread widens

Table 11: Weighted Average Interest Rates

Interest Rates	Dec-20	Monthly		Annual	
		Nov-20	Growth	Dec-19	Growth
Weighted Average Banks Deposit Rate (%)	1.982	2.011	-2.8	1.994	-1.2
Weighted Average Banks Lending Rate (%)	7.681	7.671	1.0	8.020	-33.9
Weighted Average Interest Rate Spread (%)	5.699	5.660	3.8	6.026	-32.7

Source: Banking System, National Reserve Bank of Tonga

The higher weighted average lending rates and the lower weighted average deposit rates widened the weighted average interest rate spread in December 2020 by 3.8 basis points. The higher weighted average lending rates attributed mainly to an increase in loan rates offered to the transport, professional & other business services, fisheries, and households' housing and vehicle loan rates. Both time and saving deposit interest rates declined and outweighed the rise in demand deposit rates over the month.

In year ended terms, the weighted average interest rate spread still narrowed by 32.7 basis points to 5.7%. This resulted mainly from lower weighted average lending rates offered primarily for households for other personal loans and businesses in the mining & quarrying, construction, and utilities sectors, coupled with the decrease in weighted average deposit rates (term and savings).

Outlook

The expected downturn for domestic economic growth remains. However, the Reserve Bank's monetary policy stance remains accommodative. Furthermore, the Reserve Bank is committed to continue monitoring the emerging risks prompted by uncertainties surrounding the COVID-19 pandemic, which may impact economic growth and potentially impair financial stability. The Reserve Bank remains vigilant in its regulatory and supervisory roles to ensure that financial stability is maintained whilst working to mitigate the economic downturn and support recovery.