



### Global economic growth remains gloomy

The escalating number of COVID-19 cases across the globe coupled with more protectionism policies heightens uncertainty for the future as shared by the IMF in its July 2020 update. The prospect of a COVID-19 vaccine could, however, stimulate business confidence and growth recovery. In the US, the Bureau of Economic Analysis in August 2020 reviewed its GDP growth for the June 2020 quarter to decline by an annual rate of 31.7%. This was due to lower than expected investments and consumer spending. The Reserve Bank of Australia in its August 2020 Monetary Policy Statement projects the Australian economy will contract by 6.0% in 2020 due to the associated impacts of the COVID-19 outbreak. Similarly, the Reserve Bank of New Zealand in its August 2020 Monetary Policy Statement expects their growth to decline by 5.8% for 2020.

### Festive season diminished by global pandemic

The cancellation of major events such as the Royal Agricultural Show and the Heilala Week Festival for 2020, diminishes what normally would have been a vibrant month for domestic activities, as visitors arrive in Tonga for the mid-year school holidays and to attend the festivities. Church events were also cancelled or scaled down. However, domestic activities have moderately slowed over the month as the total volume of agricultural exports decreased by 93.3 tonnes (10.1%), due to lower exports of cassava, kumara and coconuts. Nevertheless, this is still higher than the same month in the previous year indicating stronger recovery in the latter seasons. More households are involved with their own backyard farming and gardening in anticipation of a shortage in food supply due to the pandemic. This however contributes to the excess supply of local food products and lower demand. The fishing sector on the other hand, is restrained to local production, as there are minimal flights available for exports. The temporary lifting of the ban on sea cucumber harvest effective from July to September is expected to support local fishermen.

The secondary sector performed relatively well in July 2020 with few construction works being completed, including schools, individual housing, and businesses. This was part of the Pacific Resilience Program (PREP) project funded by the World Bank Group. In the year to July 2020, construction and individual housing loans increased by 10.2% and 1.5%, respectively. Meanwhile, the completed projects for the construction of foreshores at 'Ahou and Kolovai villages supported the mining and quarrying sector. The manufacturing sector also experienced positive growth as companies kept up with demand for bricks and other household building supplies. This aligns with the movements in lending for housing purposes as well as to the construction sector.

The tertiary sector continues to face weak consumption and demand from the travel restrictions and containment measures. However, Tonga has proceeded with its first repatriation flight from Fiji in its effort to return back stranded Tongans overseas. Strict quarantine measures were enforced with a compulsory 14 days' isolation in a controlled facility upon arrival. The Government used accommodation providers such as Tanoa and Kupesi Hotel as quarantine facilities thus providing some temporary relief to these inactive sectors. The trade sector showed some positive movements as container registrations rose by 12.9% in July 2020 owing largely to an increased volume of business containers, coinciding with higher import payments for wholesale and retail goods. New business ventures have been launched such as consultancies and digital agencies which are expected to add value to the services sector. Additionally, vehicle registrations rose to 304 vehicles (5.2%) in July 2020, which were mostly cars, and other light vehicles, supported by the rising remittance receipts.

### ILO survey reports significant employment reductions

An assessment survey conducted by the Tonga Chamber of Commerce and Industry (TCCI) in collaboration with the International Labor Organization (ILO) reported that COVID-19 restrictions continued to affect unemployment levels in Tonga with a loss of jobs and incomes. It was found that 16% of businesses considered closing their businesses temporarily or permanently, while 61% were planning to dismiss or had dismissed more than 41% of their workforce. The survey was completed by 216 businesses in Tongatapu, Vava'u, Ha'apai and 'Eua across 17 sectors, including hotel and tourism (28%), food and restaurants (21%), and retail and sales (12%). Enterprises surveyed employed up to 250 workers in their businesses, with most employing between 1 to 10 workers. Only 49% of businesses were still operating fully on site. Furthermore, the total number of job advertisements recorded in the Reserve Bank's survey, declined by 69 vacancies (15.1%) over the year to July 2020.

### Headline inflation continues to fall in July

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Jul-20	Jun-20	Jul-20	Jul-19
Headline Inflation (%)	0.5	-1.2	-1.1	-0.5
Domestic prices	-1.0	-1.3	-2.3	-2.4
Imported prices	1.7	-1.1	-0.1	1.1

Source: Statistics Department

An uptick in inflation for July attributes to higher imported prices during the month from the increase in fuel prices and imported food prices. Fuel prices in the region has

Table 2a: Monthly average prices of selected domestic items

Items (\$ per kg)	Unit	Monthly		
		Jul-20	Jun-20	Change
Tuna	1kg	\$17.00	\$15.00	\$2.00
Cockles (to'o)	1kg	\$6.92	\$5.47	\$1.45
Octopus	1kg	\$11.78	\$10.62	\$1.16
Capsicum	1kg	\$13.95	\$13.07	\$0.88
Yams - early	1kg	\$5.38	\$4.86	\$0.52

Source: Statistics Department



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rebounded as travel restrictions are eased improving demand for oil in the Asia-Pacific region. An increase in duty for fuel in July also supported the pick-up in fuel prices. This was partially offset by lower domestic prices from electricity (16.5%), gas & other fuels and kava Tonga. Another decline in electricity tariff was effective from 1<sup>st</sup> of July from the Tonga Power Ltd, while the declining kava Tonga prices is attributed to the reduced demand due to the night curfews.

Tonga continued to record negative inflation over the year driven mostly by the lower

domestic prices. The declining prices were for electricity, gas & other fuels, kava Tonga and local food items particularly root crops. Lower global oil prices support the declining electricity tariffs, while successful recovery efforts in the agricultural sector leads to the excess food supply. Weak demand and consumption also contributes to the declining prices of local food and kava Tonga. Import prices however marginally declined in line with the lower global oil prices.

### Declining Effective Exchange rates

**Table 3: Effective Exchange Rates**

	Monthly			Annual	
	Jul-20	Jun-20	% Growth	Jul-19	% Growth
Nominal Effective Exchange Rate Index	91.2	92.9	-1.8	91.5	-0.3
Real Effective Exchange Rate Index	105.8	106.7	-0.8	107.2	-1.3

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) declined in July 2020 as all of our major trading currencies appreciated against TOP. Similarly, the Real Effective Exchange Rate (REER) index also fell in line with the lower domestic inflation.

**Table 4: Bilateral Exchange Rates**

	Jul-20	Jun-20	Jul-19
USD/TOP	0.4390	0.4404	0.4392
AUD/TOP	0.6236	0.6380	0.6272
NZD/TOP	0.6662	0.6835	0.6562
FJD/TOP	0.9090	0.9155	0.8960
JPY/TOP	46.7876	47.2282	47.4258
GBP/TOP	0.3458	0.3507	0.3507
EUR/TOP	0.3826	0.3904	0.3903
CNY/TOP	2.8561	2.8649	2.8573

Source: Banking Systems

Over the year to July 2020, both the NEER and REER declined indicating an improvement in Tonga's trade competitiveness, supporting exporters and remittance receipts.

### Strong growth in foreign reserves

**Table 5: Foreign Reserves**

	Monthly			Annual	
	Jul-20	Jun-20	% Growth	Jul-19	% Growth
Foreign Reserves (\$ in million)	555.9	543.8	2.2	492.9	12.8
Import Coverage (months)	8.5	8.2	3.7	8.0	6.3

Source: National Reserve Bank Tonga

In July 2020, the official foreign reserves increased by \$12.1 million over the month and by \$63.0 million in the year to a new record high. This owes to inflow of remittances and project grants from development partners.

Table 6: Remittance Receipts

	Monthly			Annual		
	Jul-20	Jun-20	% Growth	Jul-20	Jul-19	% Growth
Remittance (\$ in million)	37.5	31.9	17.4	355.8	349.3	1.8

Source: National Reserve Bank Tonga

Tonga's remittance picked up strongly in July despite fears of a decline from the impact of COVID-19. All remittance receipts in AUD, USD and NZD rose in July and was supported in part by the strengthening of these currencies against the TOP. New online apps that facilitates money transfers via the Foreign exchange dealers directly into bank accounts has become popular amongst remitters during this COVID-19 environment. Majority of the remittance receipts are family support and monetary gifts which will assist in cushioning some of the fallouts in domestic activities.

Table 7: Overseas Exchange Transactions

**Overseas Exchange Transactions**

	Monthly			Annual		
	Jul-20	Jun-20	% Growth	Jul-20	Jul-19	% Growth
<b>Overall Balance</b>	<b>12.1</b>	<b>54.2</b>	<b>-77.7</b>	<b>63.0</b>	<b>16.4</b>	<b>284.1</b>
<b>Current Account</b>	<b>4.1</b>	<b>40.9</b>	<b>-90.0</b>	<b>56.7</b>	<b>-2.4</b>	<b>2462.5</b>
Merchandise Trade	-33.7	-36.3	7.2	-399.1	-421.6	5.3
Services	-0.4	-3.8	89.5	12.5	32.2	-61.2
Income	2.6	2.4	8.3	7.0	8.1	-13.6
Transfers	35.6	78.7	-54.8	436.4	378.8	15.2
<b>Capital Account</b>	<b>1.6</b>	<b>4.3</b>	<b>-62.8</b>	<b>23.6</b>	<b>38.5</b>	<b>-38.7</b>
<b>Financial Account</b>	<b>6.4</b>	<b>8.9</b>	<b>-28.1</b>	<b>-17.3</b>	<b>-19.6</b>	<b>11.7</b>

Source: Banking Systems

Overall, Overseas Exchange Transactions (OET) recorded a lower surplus in July 2020 in line with the decline in official transfer receipts significantly reducing the current account surplus. The capital and financial account also recorded lower surpluses in July.

Over the year to July 2020, the overall balance surplus widened significantly supported by the increase in official transfers receipts and remittances, while imports of goods and services declined. This more than offset the decline in the capital account surplus while the financial account deficit slightly improved.

### Broad money increased on higher foreign reserves

Table 8: Broad Money

	Monthly			Annual	
	Jul-20	Jun-20	% Growth	Jul-19	% Growth
Broad money (\$ in million)	616.9	607.1	1.6	595.3	3.6
Net Foreign Asset	578.9	570.6	1.5	510.0	13.5
Net Domestic Asset	38.5	37.2	3.6	85.7	-55.1

Source: Banking System, National Reserve Bank of Tonga

The monthly rise in the level of foreign reserves continued to drive the net foreign assets higher and consequently the level of money supply. Hence, broad money rose over the month and year to July 2020 by \$9.8 million and \$21.6 million.



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million respectively. Net domestic assets also supported the monthly movement with higher drawdowns of government deposits from the Reserve Bank to cater for government operations. In the year to July, net domestic assets declined attributing to the receipts of budget support and COVID-19 funds.

### More liquidity in the financial system

Table 9: Reserve money

	Monthly			Annual	
	Jul-20	Jun-20	% Growth	Jul-19	% Growth
Reserve money (\$ in million)	332.2	311.7	6.6	309.0	7.5

Source: Banking System, National Reserve Bank of Tonga

The higher reserve money in July 2020 stems from a rise in the commercial banks' ESA (Exchange Settlement Account), coinciding with the rise in banks' total deposits. Currency in circulation and banks required reserves also increased over the month and supported the liquidity in the banking system.

### Lower lending activities

Table 10: Total Lending

Lending	Monthly			Annual	
	Jul-20	Jun-20	% Growth	Jul-19	% Growth
Total Lending (\$ in million)	490.4	492.9	-0.5	490.8	-0.1
Business lending	231.5	234.5	-1.3	231.5	0.0
Household lending	258.9	258.4	0.2	259.2	-0.1
Other lending	0.0	0.0	0.0	0.2	-100.0

Source: Banking System, National Reserve Bank of Tonga

Despite the excess liquidity, the Bank's lending continued to fall in July 2020 by \$2.5 million depicting low business confidence and weak investment appetite. Although individual loans for housing and other personal loans increased over the month, they were offset by the lower business loans to the professional & other services, manufacturing, and agricultural sectors.

Total deposits, however, rose by \$5.9 million (1.0%) in July 2020 mainly from the central government and the private sector. The rise in remittance receipts also contributes to household savings. This also links to the fall in consumer demand despite rising remittances. In addition to the cancellation of events, consumers were more cautious by

budgeting spending and set aside more savings due to the uncertainly posed by COVID-19.

As such, the banks' total loans to deposit ratio declined to 76.8% from 77.9% in June 2020, below the 80% minimum.

### Narrowing average lending rates

Table 11: Weighted Average Interest Rates

Interest Rates	Jul-20	Monthly		Annual	
	Jul-20	Jun-20	Growth	Jul-19	Growth
Weighted Average Banks Deposit Rate (%)	2.133	2.139	-0.7	1.925	20.7
Weighted Average Banks Lending Rate (%)	7.806	7.815	-0.8	8.033	-22.6
Weighted Average Interest Rate Spread (%)	5.674	5.675	-0.1	6.107	-43.3

Source: Banking System, National Reserve Bank of Tonga

The weighted average interest rate spread decreased in July 2020 as the weighted average lending rates for both businesses and household loans fell in line with the fall in banks' total lending. Some banks offered lower interest rates to selected customers as part of their relief package for COVID-19, supporting the lower average lending rates. However, the weighted average deposit rates declined due to lower rates offered for demand, savings, and time deposits.

Similarly, the weighted interest rate spread narrowed in the year to July 2020. The weighted average lending rates declined mainly on household loans as well as business loans for the mining & quarrying, tourism, fisheries, and professional & other services sectors.

### Outlook

Given the above developments, the comfortable level of foreign reserves, the low levels of inflation, and excess liquidity in the banking system, the Reserve Bank's monetary policy stance remains unchanged. The accommodative policy stance will continue to support domestic activities and macroeconomic growth. However, the Reserve Bank remains vigilant by closely monitoring the financial and economic indicators for early signs of vulnerability. In addition to its financial contribution to the fiscal stimulus package, the Reserve Bank is also exploring other measures to support the economy during this difficult time.