



US economy shows recovery yet global risks heighten

Negative shocks imposed by the COVID-19 pandemic continues to be felt across all economies. In particular, global remittances is expected to drop by 7.0% in 2020 and further by 7.1% in 2021 as reported by the World Bank Group in October 2020. This is due to fewer job opportunities as well as the repatriation of migrant workers to their respective home countries. However, the US economy noted recovery in the year to September 2020 with an annual growth rate of 33.1%. This reflected improvements in consumption spending, investments, and export activities as businesses resume in line with the ease of COVID-19 restrictions. Meanwhile, the Reserve Bank of Australia in November 2020 has further reduced its cash rate by 0.15% to 0.1% mainly to support investment and economic recovery. The Reserve Bank of New Zealand maintained its Official Cash Rate at 0.25% to continue supporting economic recovery.

Slow paced economic growth for Tonga in September

Activities in the primary sector were mostly slow paced yet positive in September 2020. Fish exports increased in the month by 81.0 tonnes (90.3%) to a total of 170.8 tonnes, owing mostly to exported tuna. Additionally, the export of aquarium products rose by 4,405 pieces (54.8%) supported by airfreight services of returning repatriation flights. The temporary lifting of the ban on sea cucumber harvest contributed to the rise in sea cucumber exports with a total of 15 tonnes in September 2020. Monthly agricultural export volumes rose by 499.6 tonnes (64.3%) due to higher exports of squash, taro, and cassava. Export proceeds, however, declined over the month and year by \$0.3 million (47.7%) and \$4.0 million (37.4%) respectively. This is possibly due to the lag in receiving proceeds. Local supply of agricultural produce such as kava Tonga and vegetables have evidently improved and is reflected by lower prices compared to September 2019.

The industry sector picked up during the month particularly for the construction sector attributed to the completion of school buildings, private housings, and health facilities. This coincided with the \$0.3 million (7.2%) rise in import payments for construction materials. Over the year, lending to businesses in the construction sector increased by \$0.4 million (4.0%) with individual housing loans also rising by \$3.0 million (1.5%). Furthermore, some of the ongoing major infrastructure projects such as the Nationwide Early Warning System (NEWS) and Pacific Resilience Program (PREP) Project is expected to support activities in the sector.

Performance in the services sector largely remained subdued in September 2020. Travel receipts slightly fell by \$0.03 million (1.4%) as the border remains closed except for the repatriation flights from Fiji, Kiribati, and the Solomon Islands. Container registrations also declined by 127 registrations (26.2%) during the month driven by lower

private containers. This may attribute to the decline in stimulus packages implemented abroad thus lower private containers. Meanwhile, import payments declined by \$0.4 million (1.2%) due to decreases in oil import, motor vehicles, and other imported goods. On the other hand, vehicle registrations rose by 20 vehicles (6.3%) over the month which aligns with the higher lending on vehicles to individuals.

Job opportunities remain restricted

The Reserve Bank's survey on job advertisements continued to decline in the year to September 2020 by 96 vacancies (22.4%). This is largely due to the impacts of COVID-19 pandemic especially for employment opportunities in the tourism and accommodation sectors. As the COVID-19 continues to take its toll on the economy, unemployment remains a downside risk hampering economic growth and productivity. The COVID-19 pandemic continues to restrict job opportunities and is likely to continue in the near-term.

Lower annual prices for the fourth consecutive month

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Sep-20	Aug-20	Sep-20	Sep-19
Headline Inflation (%)	0.6	-0.1	-0.9	0.4
Domestic prices	1.2	-1.1	-1.5	-1.1
Imported prices	0.2	0.7	-0.5	1.6

Source: Statistics Department

Prices rose in the month of September 2020 and was largely driven by the increase in domestic items, specifically, for root crops, and octopus. Meanwhile, higher imported prices for fuel contributed to the higher prices in the month particularly for petrol resulting from higher crude oil prices.

The annual headline inflation for September 2020 continued to decline for the fourth consecutive month. This was due to lower domestic and imported prices.

The decline in electricity, gas & other fuels, and kava Tonga were significant drivers of lower domestic prices. Similarly, lower imported prices attributed to the decline in transportation items, household maintenance, electricity, gas & other fuels. Inflation is expected to decline for the remainder of 2020 due to weaker demand coupled with falling global oil prices.

Table 2: Average annual prices of selected items

Items (\$ per kg)	Unit	Sep-20	Sep-19	Annual Change
Domestic				
Kava	1kg	\$60.00	\$105.00	-\$45.00
Tomatoes	1kg	\$3.36	\$6.84	-\$3.48
H/Cabbage	1kg	\$0.90	\$2.28	-\$1.38
Lu	1kg	\$4.59	\$5.40	-\$0.81
Imported				
Chicken pieces	1kg	\$3.30	\$4.48	-\$1.18
Turkey tails	1 kg	\$9.27	\$9.99	-\$0.72
Diesel	1 litre	\$2.44	\$2.78	-\$0.34

Source: Statistics Department

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Effective Exchange rates decline further

The Nominal Effective Exchange Rate (NEER) declined in



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Table 3: Effective Exchange Rates

	Monthly			Annual	
	Sep-20	Aug-20	% Growth	Sep-19	% Growth
Nominal Effective Exchange Rate Index	90.1	90.8	-0.7	92.6	-2.6
Real Effective Exchange Rate Index	103.9	104.2	-0.3	108.7	-4.4

Source: National Reserve Bank of Tonga

September 2020 reflecting the appreciation in major trading currencies against the Tongan Pa'anga (TOP). The Real Effective Exchange Rate (REER) index also fell in line with Tonga's lower inflation rate compared to most of its major trading partners

Both the NEER and REER were also lower compared to the previous year indicating an improvement in Tonga's trade competitiveness, supporting export proceeds and remittance receipts.

Table 4: Bilateral Exchange Rates

	Sep-20	Aug-20	Sep-19
USD/TOP	0.4381	0.4386	0.4312
AUD/TOP	0.6039	0.6086	0.6323
NZD/TOP	0.6558	0.6640	0.6787
FJD/TOP	0.8970	0.9028	0.8904
JPY/TOP	46.1751	46.3982	46.1576
GBP/TOP	0.3365	0.3332	0.3484
EUR/TOP	0.3705	0.3701	0.3910
CNY/TOP	2.8500	2.8536	2.8053

Source: Banking Systems

Foreign reserves peak while remittances drop

Table 5: Foreign Reserves

	Monthly			Annual	
	Sep-20	Aug-20	% Growth	Sep-19	% Growth
Foreign Reserves (\$ in million)	576.5	556.1	3.7	490.8	17.5
Import Coverage (months)	10.0	9.6	0.4	8.0	25.2

Source: National Reserve Bank Tonga

The official foreign reserves rose by \$20.4 million over the month to \$576.5 million, equivalent to 10.0 months of imports. The monthly increase was from the receipt of budget support and project grant funds in addition to remittance receipts. Similarly, the foreign reserves also increased over the year by \$85.7 million attributed mainly to receipts of budget support and official grants from development partners, and remittances. The foreign reserves are mostly held in USD, AUD, and NZD.

Table 6: Remittance Receipts

	Monthly			Annual		
	Sep-20	Aug-20	% Growth	Sep-20	Sep-19	% Growth
Remittance (\$ in million)	36.0	36.5	-1.3	369.2	349.4	5.7

Source: National Reserve Bank Tonga

Remittances fell in September 2020 by \$0.5 million (1.3%), yet this is higher than the same month of last year. This resulted from lower receipts of private transfers and private capital transfers. In year ended terms, higher private transfers and compensation of employees drove the \$19.8 million increase in remittances.

Table 7: Overseas Exchange Transactions
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	Monthly			Annual		
	Sep-20	Aug-20	% Growth	Sep-20	Sep-19	% Growth
Overall Balance	20.4	0.1	20300.0	85.7	38.7	121.4
Current Account	9.1	1.5	506.7	81.6	6.1	1237.7
Merchandise Trade	-34.5	-34.5	0.0	-396.5	-415.6	4.6
Services	-1.3	-1.7	23.5	5.7	33.3	-82.9
Income	2.6	1.6	62.5	12.2	6.2	96.8
Transfers	42.4	36.0	17.8	460.2	382.1	20.4
Capital Account	4.0	0.7	471.4	25.4	36.1	-29.6
Financial Account	7.3	-2.0	465.0	-21.4	-3.5	-511.4

Source: Banking Systems

Overall Overseas Exchange Transactions (OET) recorded a higher surplus of \$20.4 million in September 2020, than the \$0.1 million in the previous month. This resulted from an increase in OET receipts mainly from transfer receipts. Annually, the OET balance surplus increased substantially by \$47.0 million in the year to September 2020, underpinned by the higher current account surplus. The strong growth in the current account is due to higher official transfer receipts, lower merchandise trade deficits, and higher income receipts. However, the capital account recorded a lower surplus during the year driven by declines in both private and official capital receipts. The financial account deficit rose annually due to transfers of offshore investments and external debt repayments.

The NRBT expects foreign reserves levels to be well above the 3 months minimum threshold of import cover in the near term, supported by receipts of budget support from donor partners and lower import payments.

Inflow of funds lead broad money to rise

Table 8: Broad Money

	Monthly			Annual	
	Sep-20	Aug-20	% Growth	Sep-19	% Growth
Broad money (\$ in million)	640.8	624.7	2.6	594.5	7.8
Net Foreign Asset	605.4	582.4	3.9	504.5	20.0
Net Domestic Asset	36.5	43.0	-15.0	90.7	-59.7

Source: Banking System, National Reserve Bank of Tonga

The receipts of grants and budget support pushed net foreign assets higher in September 2020. This led the broad money to a new high level of \$640.8 million. Net domestic assets, however, decreased due to higher government deposits from receiving of these grants and budget support.

Higher liquidity in the financial system

Table 9: Reserve money

	Monthly			Annual	
	Sep-20	Aug-20	% Growth	Sep-19	% Growth
Reserve money (\$ in million)	351.7	336.3	4.6	317.4	10.8

Source: Banking System, National Reserve Bank of Tonga

Liquidity in the banking system also reached a new high level in September 2020, as a result of \$13.3 million rise in the commercial banks' ESA (Exchange Settlement Account) which coincided with the higher banks' total deposits over the month. Currency in circulation and required reserves also increased over the month and supported the higher total reserve money.

Credit growth rebounds driven by the private sector

Table 10: Total Lending

Lending	Monthly			Annual	
	Sep-20	Aug-20	% Growth	Sep-19	% Growth
Total Lending (\$ in million)	491.1	487.6	0.7	493.9	-0.6
Business lending	232.7	229.0	1.6	235.2	-1.1
Household lending	258.4	258.7	-0.1	258.5	0.0
Other lending	0.0	0.0	0.0	0.3	-100.0

Source: Banking System, National Reserve Bank of Tonga

After declining for three consecutive months due to the uncertainties of COVID-19, the banks total lending



increased in September 2020 by \$3.4 million. This attributed mainly to new loans offered to the private sector especially businesses in the professional & other services sector, and households' housing loans. However, total banks' lending declined annually by \$2.8 million as a result of lower lending to both businesses and households. Uncertainties surrounding COVID-19 has weakened investment appetite, and contributes to higher risk aversion of banks.

Total deposits rose by \$18.0 million (2.8%) to a new high level of \$650.5 million in September 2020, due mainly to higher demand and saving deposits. More deposits made by businesses, government, and public enterprises drove higher demand deposits whereas individuals and non-profit organisations such as churches saved more. As the rise in banks' total loans was lower than the rise in total deposits, the loans to deposit ratio declined to 74.0% from 75.5% in August 2020, below the 80% minimum.

Money supply and liquidity is projected to still remain high whereas credit growth will continue to trend downwards. Deposits are also expected to remain high as demand remains weak in addition to minimal investment opportunities available locally.

Average interest rates shrink driven largely by lending

Table 11: Weighted Average Interest Rates

Interest Rates	Sep-20	Monthly		Annual	
		Aug-20	Growth	Sep-19	Growth
Weighted Average Banks Deposit Rate (%)	2.095	2.130	-3.4	1.944	15.2
Weighted Average Banks Lending Rate (%)	7.693	7.799	-10.6	7.999	-30.6
Weighted Average Interest Rate Spread (%)	5.598	5.669	-7.1	6.055	-45.7

Source: Banking System, National Reserve Bank of Tonga

Both the weighted average lending and deposit rates fell in September 2020. The lower weighted average lending rate declined mostly and was due to lower rates extended to businesses in the agriculture, distribution and professional & other services sectors as well as households' other personal loans. This was in line with the growth of loans over the month. Similarly, the decline in the weighted average deposit rate was solely driven by lower saving deposit rates. As a result, the weighted average interest rate spread narrowed yet again in September 2020 by 7.1 basis points.

Annually, the weighted average interest rate spread decreased by 45.7 basis points due to a lower weighted average lending rate coupled with the higher weighted average deposit rate. The higher volume of deposits supported the increased weighted average deposit rates over the year.

Outlook

Considering the monthly developments above, the expected downturn for economic growth still stands. The Reserve Bank's monetary policy stance remains accommodative. Additionally, the Reserve Bank is committed to continue monitoring the emerging risks prompted by the prolonged state of the COVID-19 pandemic that can impact economic growth and potentially impair financial stability. As such, the Reserve Bank remains vigilant in its regulatory and supervisory roles to ensure financial stability is maintained, while at the same time mitigating the economic downturn and supporting recovery.