



### Stagflation Risk Rises says World Bank

According to the World Bank’s Global Economic Prospects in June 2022, the risk of stagflation is growing considerably amid weaker global growth. The global growth forecast for 2022 has been revised down from 4.1% to 2.9%, compounded by the war-induced disruptions, faded pent-up demand, and withdrawal of substantial policy support. Inflation, on the other hand, is projected to peak in mid-2022 before easing in mid-2023. The US annual inflation slightly eased from the 41-year high of 8.5% in the previous month to 8.3% in April 2022. However, the Federal Reserve remains determined with further interest rate hikes to moderate inflation. Australia is challenged by more accelerated inflation than anticipated. The Reserve Bank of Australia in its May 2022 Monetary Policy Statement (MPS) projects inflation to peak around 6.0% in the second half of 2022, while the economy remains resilient. Nevertheless, growth is anticipated to abate in 2023 due to the withdrawal of policy support, lower real income, and slower consumption growth. In the May 2022 Reserve Bank New Zealand (RBNZ) MPS, the official cash rate was raised by 0.5 percentage points to 2%, and it is forecasted to reach nearly 4.0% by the second half of 2023 and through to 2024. Inflation is also expected to peak in the June 2022 quarter at 7.0%, driven by the aggravated disruptions to supply chains and surging global commodities prices. The RBNZ is also concerned about the rising global interest rates as it further pressures New Zealand import prices.

### Domestic activities slowly resume from lockdown

Tonga finally ended a three weeks red-alert lockdown on the 11<sup>th</sup> of April, as positive cases declined significantly. In moving to orange light, some of the Covid-19 restrictions were eased. Government ministries and the majority of the businesses in the private sector were allowed to resume operations provided they are granted a permit from the Ministry of Health confirming that they meet the Covid-19 safety requirements.

The primary sector is slowly recovering from the impacts of the Hunga Tonga – Hunga Ha’apai (HTHH) disaster and the Covid-19 outbreak, although not as strong as the previous year’s performance. Agricultural export volumes increased in April by 184.5 tonnes (72.6%) owing to higher exports of cassava by 76.7 tonnes (106.6%) and kava Tonga by 18.1 tonnes (91.9%). Over the year, agricultural exports declined by 1,216 tonnes (11.4%) due mainly to lower exports of yam by 1,053.2 tonnes (49.7%), and taro by 641.7 tonnes (29.7%) reflecting the HTHH damages. Agricultural proceeds slightly declined by \$0.04 million (9.8%) over the month but rose annually by \$0.9 million (13.9%) corresponding to the higher proceeds from squash exports.

The industrial sector is gaining some positive activities from the construction sector as the Government rolls out its reconstruction projects from the HTHH disaster, which coincides with the \$0.2 million (1.1 %) increase in loans to

construction during the month. On the other hand, a new electricity tariff was effective in April, increasing by 6.90 seniti to 97.91 seniti per kWh as a result of the higher diesel prices. The Government has also responded by allocating a \$1.7 million subsidy to assist households with their electricity bills. Consequently, the rising energy prices will also be factored into domestic production prices and adding on to inflation.

The majority of the tertiary sector was able to resume operations with some restrictions being observed particularly for social distancing. Dining in restaurants was allowed, the Talamahu market opens, and churches can hold services. Schools, however, were still closed while the vaccines for children ages 5 to 11 were rolled out. Bars and kava clubs also remained closed. Private container registrations declined by 52.6% (313 containers) in April driving the overall decline in container registrations, reflecting the slowdown in humanitarian support and in-kind remittances from families and relatives abroad. Business containers, on the other hand, rose by 5.5% (21 containers) depicting a pick up in trading activities as restrictions ease. Fewer passengers arrived during the month, but quarantine period has been reduced to 10 days only and allowing for more repatriate flights in the upcoming months.

### Fewer job opportunities during April

The Reserve Bank survey recorded a substantial decline in April in the job vacancies compared to last month. The majority of the job vacancies advertised were from public administration. Annually, job vacancies rose by 242 vacancies (121.6%) reflecting higher demand for employment.

### Strong rebound in headline inflation to 9.4%

The ongoing supply disruptions from the global pandemic and the Russia-Ukrainian war continue to push global oil, food, and commodity prices higher amidst surging freight rates. Elevated inflation is observed amongst our major trading partner countries and flows through imports to Tonga’s inflation. Higher fuel prices also pass through to domestic energy prices and production prices. Shocks from natural disasters and national lockdowns also trigger higher domestic prices.

Inflation rose over the month by 1.8%, attributed to increases in both imported

| Prices                 | Monthly |        | Annual |        |
|------------------------|---------|--------|--------|--------|
|                        | Apr-22  | Mar-22 | Apr-22 | Apr-21 |
| Headline Inflation (%) | 1.8     | 0.2    | 9.4    | 4.5    |
| Domestic prices        | 0.8     | -1.2   | 8.1    | 3.1    |
| Imported prices        | 2.6     | 1.4    | 10.5   | 5.6    |

Source: Tonga Statistics Department

and domestic prices. Higher fuels and food prices contributed to the monthly increase in imported prices. Domestic food prices also rose over the month, particularly seafood, several vegetables, and root crops. This also led to an increase recorded for takeaway food prices as



restaurants and catering businesses resumed full operations during the month.

The annual headline inflation also rose by 9.4% in April 2022, the largest 12-month increase since June 2017. The annual increase in domestic prices is largely owed to higher prices of food items and electricity. Meanwhile, the elevated imported prices were from higher prices of fuels, food items, construction materials, and liquefied petroleum gas.

### Effective exchange rates increased again in April

Table 3: Effective Exchange Rates

|                                       | Monthly |        |          | Annual |          |
|---------------------------------------|---------|--------|----------|--------|----------|
|                                       | Apr-22  | Mar-22 | % Growth | Apr-21 | % Growth |
| Nominal Effective Exchange Rate Index | 92.8    | 90.6   | 2.4      | 87.2   | 6.4      |
| Real Effective Exchange Rate Index    | 115.2   | 111.0  | 3.8      | 104.1  | 10.7     |

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) increased over the month reflecting the general weakening of the major trading partners' currencies against the Tongan pa'anga (TOP) except for the AUD. The Real Effective Exchange Rate (REER) index increased over the month coinciding with the higher inflation rate.

In the year to April 2022, the NEER still increased as trading partners' currencies generally weakened against the TOP. The REER also increased over the year in line with the higher inflation rate, indicating a loss in trade competitiveness.

### Foreign reserves picked up from higher official funds

Table 4: Foreign Reserves

|                                  | Monthly |        |         | Annual |          |
|----------------------------------|---------|--------|---------|--------|----------|
|                                  | Apr-22  | Mar-22 | %Growth | Apr-21 | % Growth |
| Foreign Reserves (\$ in million) | 884.0   | 861.4  | 2.6     | 679.7  | 30.1     |
| Import Coverage (months)         | 12.6    | 13.2   | -4.5    | 11.7   | 7.7      |

Source: National Reserve Bank Tonga

Foreign reserves markedly rose in April 2022 by \$22.6 million to \$884.0 million, equivalent to 12.6 months of imports. This stemmed mostly from receipts of relief funds from the Government's development partners to support the country's recovery from the HTHH disaster, in addition to remittance receipts. Annually, foreign reserves rose substantially by \$204.4 million underpinned by higher receipts of budget support, official grants, capital inflows, and remittances. The majority of the official foreign reserves are held in USD, AUD, and NZD.

Table 5: Remittance Receipts

|                            | Monthly |        |          | Annual |        |          |
|----------------------------|---------|--------|----------|--------|--------|----------|
|                            | Apr-22  | Mar-22 | % Growth | Apr-22 | Apr-21 | % Growth |
| Remittance (\$ in million) | 38.7    | 32.0   | 21.1     | 474.4  | 447.6  | 6.0      |

Source: National Reserve Bank Tonga

Total remittance receipts continued to rise by \$6.7 million (21.1%) to \$38.7 million in April 2022 as banks and foreign exchange dealers resume normal operations. The rise was mainly driven by higher private transfer receipts, mostly in USD, AUD, and NZD. Private transfers are mostly family support and gifts from the Tongan diaspora. Annually, remittances continued to increase by \$26.8 million (6.0%) owing to higher private transfers, receipts for compensation of employees, and private capital transfers.

Table 6: Overseas Exchange Transactions

|                   | Monthly |        |          | Annual |        |          |
|-------------------|---------|--------|----------|--------|--------|----------|
|                   | Apr-22  | Mar-22 | % Growth | Apr-22 | Apr-21 | % Growth |
| Overall Balance   | 22.6    | -5.8   | 487.7    | 204.4  | 204.6  | -0.1     |
| Current Account   | 16.8    | 7.7    | 117.2    | 145.7  | 152.3  | -4.3     |
| Merchandise Trade | -44.4   | -34.4  | -28.9    | -474.1 | -440.6 | -7.6     |
| Services          | -14.7   | -6.4   | -129.6   | -61.7  | -14.5  | -326.2   |
| Income            | 3.3     | 0.9    | 259.6    | 24.7   | 33.4   | -26.1    |
| Transfers         | 72.6    | 47.6   | 52.3     | 656.8  | 573.9  | 14.4     |
| Capital Account   | 0.7     | 1.3    | -44.5    | 17.1   | 42.5   | -59.7    |
| Financial Account | 5.1     | -14.8  | 134.3    | 41.5   | 9.8    | 325.8    |

Source: Banking Systems

The Overseas Exchange Transactions (OET) recorded an overall balance surplus of \$22.6 million in April 2022 compared to a \$5.8 million deficit in March 2022. This was attributed mostly to an increase in the current account, particularly from the higher official transfer receipts.

In the year to April 2022, the OET balance surplus declined slightly by \$0.2 million to \$204.4 million. This was mainly underpinned by lower surpluses in the capital account (lower official capital receipts), and the current account (widening services and trade deficit).

### Broad money declined further

Table 7: Broad Money

|                             | Monthly |        |          | Annual |          |
|-----------------------------|---------|--------|----------|--------|----------|
|                             | Apr-22  | Mar-22 | % Growth | Apr-21 | % Growth |
| Broad money (\$ in million) | 844.3   | 844.9  | -0.1     | 712.3  | 18.5     |
| Net Foreign Asset           | 870.8   | 852.8  | 2.1      | 715.5  | 21.7     |
| Net Domestic Asset          | -26.1   | -7.0   | -272.1   | -2.3   | -1059.4  |

Source: Banking System, National Reserve Bank of Tonga

Broad money fell again in April by \$0.6 million (0.1%), however, still rose annually by \$131.9 million (18.5%). The net domestic assets decreased over the month, driven by higher Government deposits which offset the increase in net foreign assets.

Over the year, the net foreign assets increased significantly in line with the rising foreign reserves, which more than offset the decline in net domestic assets from the rising Government deposits.

### Liquidity in the financial system increased

Table 8: Reserve money

|                               | Monthly |        |          | Annual |          |
|-------------------------------|---------|--------|----------|--------|----------|
|                               | Apr-22  | Mar-22 | % Growth | Apr-21 | % Growth |
| Reserve money (\$ in million) | 600.5   | 598.0  | 0.4      | 447.0  | 34.3     |

Source: Banking System, National Reserve Bank of Tonga

Liquidity in the financial system rose over the month and year to April 2022, by \$2.4 million (0.4%) and \$153.5 million (34.3%) respectively. The Exchange Settlement Accounts (ESA) increased over the month reflecting higher net



deposits by the commercial banks to the Reserve Bank vault. This more than offset the decline in the Statutory Reserve Deposits (SRD) and currency in circulation.

Annually, liquidity continued to expand with ESA rising the most as a result of high foreign currency receipts. The currency in circulation and SRD also increased, reflecting higher demand for money and the growth in deposits over the year.

### Credit growth remains subdued

Table 9: Total Lending

| Lending                       | Monthly |        |          | Annual |          |
|-------------------------------|---------|--------|----------|--------|----------|
|                               | Apr-22  | Mar-22 | % Growth | Apr-21 | % Growth |
| Total Lending (\$ in million) | 466.7   | 468.1  | -0.3     | 488.1  | -4.4     |
| Business lending              | 213.9   | 213.4  | 0.2      | 229.4  | -6.8     |
| Household lending             | 251.0   | 252.9  | -0.7     | 258.2  | -2.8     |
| Other lending                 | 1.8     | 1.8    | -0.1     | 0.4    | 339.2    |

Source: Banking System, National Reserve Bank of Tonga

The banks' total lending decreased again in April 2022, by \$1.3 million (0.3%) over the month, and \$21.3 million (4.4%) annually. The monthly decline was solely driven by lower household loans, whilst business loans slightly increased.

Over the year, both business and household loans fell. The loan repayments made by public enterprises and businesses such as those in the professional & other business services, constructions, and agricultural sectors contributed to the annual decline, while all household loans also fell. Credit growth continued to be dampened by the domestic and global shocks to the economy, and the high degree of uncertainties

Total deposits increased over the month by \$9.1 million (1.1%), and over the year by \$126.9 million (17.6%) to a total of \$848.2 million. The stronger deposits growth compared to the weak lending growth over the month and year, resulted in a lower loans to deposit ratio of 53.9%, compared to 54.6% last month, and 66.0% in April last year. This is still below the new minimum threshold of 70%.

### Weighted average interest rate spread widened

In April 2022, the weighted average interest rate spread widened over the month and year to 6.18%. The weighted average deposit rate decreased for all categories in both

periods. The weighted average lending rates rose over the month driven by higher business lending rates offered to the agricultural, construction, and professional & other services sectors. Similarly, over the year, higher loan rates were offered to businesses within the utilities, construction, and agricultural sectors. Household housing loan rates also increased over the year.

Table 10: Weighted Average Interest Rates

| Interest Rates                            | Monthly |        |       | Annual |       |
|---|---------|--------|-------|--------|-------|
|   | Apr-22  | Mar-22 | (bps) | Apr-21 | (bps) |
| Weighted Average Banks Deposit Rate (%)   | 1.656   | 1.705  | -4.9  | 1.978  | -32.3 |
| Weighted Average Banks Lending Rate (%)   | 7.835   | 7.829  | 0.6   | 7.711  | 12.4  |
| Weighted Average Interest Rate Spread (%) | 6.179   | 6.124  | 5.5   | 5.733  | 44.6  |

Source: Banking System, National Reserve Bank of Tonga

### Outlook

Uncertainties on the duration of the Covid-19 outbreak will continue to constrain domestic economic recovery from recent disasters in the near term. Spillover effects from the war in Ukraine, the China lockdowns, and the supply-demand mismatches will keep inflation elevated. Foreign reserves are anticipated to remain comfortable with adequate capacity to sustain high probability shocks. The financial system remains stable with adequate capital to absorb any shocks to the system, however, non-performing loans is slowly increasing.

The Reserve Bank recognises that the trade-off between supporting economic recovery and countering inflation requires delicate balancing actions. Against this background, it has considered its current accommodative stance appropriate at this time to work in tandem with the fiscal policies in reviving the economy and preventing any further contraction in growth. With regards to inflation, the Reserve Bank notes that these pressures are supply-driven and are beyond its control. Our major trading partner countries are already fighting inflation through the tightening of their monetary policies which will flow through in import prices to Tonga's inflation. The Reserve Bank adopts a wait-and-see approach on these actions to take effect and will stand ready to realign its monetary policy should inflation continue to increase unsustainably.