



Soaring oil prices exacerbate inflation outlook

The Russo-Ukrainian crisis markedly lifted the energy and commodities prices. Increasing Western sanctions on Russia, and the exit of energy giants such as British Petroleum (BP) and Shell, further extended the oil supply constraints and thereby aggravating global inflation. According to Reuters, Brent and West Texas Intermediate (WTI) prices hit their highest levels since 2013, with the Brent price rising above \$105/barrel. The International Monetary Fund (IMF) expects the Ukraine war to hasten consumer-price increases. In February 2022, the US annual inflation rose by 7.9%, the largest increase since 1982. Meanwhile, the Reserve Bank of Australia reported sped up inflation due to the Ukraine war, resulting in commodities price increases and flaring petrol prices. Nevertheless, the economy remains resilient following the Omicron setback, evident in the labour market with a 14-year low unemployment rate of 4.2%. New Zealand is also experiencing accelerated inflation. The Reserve Bank of New Zealand (RBNZ) lifted the official cash rate by 25 basis points to 1% in February 2022. Surging fuel prices are prevalent, and both firms and households are facing soaring costs. The RBNZ is therefore anticipating a continuous lift in the official cash rate.

Covid-19 national lockdown halts domestic activities

The Tongan economy suffered a double crisis with the Hunga Tonga Hunga Ha'apai (HTHH) volcanic eruption in January 2022, followed by the community outbreak of Covid-19 in February. The main island of Tongatapu went into a 3-week hard lockdown during the month, with all businesses and workplaces closed except for health essential services. Schools, churches, and public places were also closed with strict curfews being observed. Shops and banks were allowed to open for a couple of days during the week for households to restock their supplies. These events significantly impacted domestic production and output.

The severe impact of the HTHH disaster is evident in the primary sector, particularly agriculture. Despite a slight rise in agricultural export volumes over the month by 72.4 tonnes (36.7%) driven by taro and yam exports, the total monthly export is still significantly lower than the normal monthly averages before the HTHH disaster. Over the year, agricultural exports increased by 882.9 tonnes (8.9%) driven mostly by squash, cassava, and watermelon exports which were harvested before the HTHH event. This coincides with the \$0.4 million (5.1%) increase in agricultural export proceeds. Marine exports are showing less impact from the natural disaster, with a monthly increase of 15.7 tonnes (45.8%) mostly from exports of tuna (14.9 tonnes), and shark meat (0.8 tonnes). Aquarium export volumes also increased by 425 pieces (42.4%) driven by higher exports of invertebrates, soft corals, and live fish. Annually, marine exports increased by 215.7 tonnes (17.0%) similar to aquarium exports rising by 23,855

pieces (20.5%), coinciding with the annual increase in marine export proceeds by \$0.6 million (13.9%).

The industry sector performance was further disrupted by the national lockdown, with construction activities being halted and further delayed. On the other hand, electricity consumption rose over the month by 12.7% reflecting higher usage by households during the lockdown. Loans to the utility sector increased by \$2.0 million (0.4%) in February, while construction loans fell by \$0.5 million (3.0%).

The tertiary sector was the most affected by the extended national lockdown, while they are still trying to recover from the damages of the HTHH disaster. All non-essential businesses were directed to cease all operations during the lockdown. Financial services were very limited to payout of remittances, deposits, and withdrawals. The majority of Tonga's private sector are contact-intensive industries that cannot operate in the virtual world yet. Small businesses may not have enough reserves to pay their employees during this difficult time highlighting the significance of remittances as a social safety net for Tonga. Container registrations markedly rose in February by 254 registrations (40.1%) of which the majority were from private containers reflecting a pickup in remittances in-kind such as boxes and drums of food and household items from family and relatives abroad sent as part of the HTHH disaster relief assistance. Business containers also rose in line with the higher monthly import payments for wholesale & retail trade goods. Repatriation flights also resumed in February 2022, while more seasonal workers depart for work in Australia and New Zealand.

Domestic price shocks contribute to inflation

Domestic prices drove the rise in the monthly and annual inflation in February 2022, reflecting the shocks from the HTHH disaster on the domestic food supply and the demand surge from the Covid-19 lockdown. Headline inflation rose by 2.0% over the month, of which 1.8% was

Prices	Monthly		Annual	
	Feb-22	Jan-22	Feb-22	Jan-22
Headline Inflation (%)	2.0	-0.3	9.1	8.2
Domestic prices	3.7	-0.8	9.2	6.2
Imported prices	0.6	0.1	8.9	9.7

Source: Tonga Statistics Department

Items (\$ per kg)	Unit	Feb-22	Annual	
			Feb-21	Change
Domestic				
Capiscium	1kg	\$44.74	\$19.96	\$24.78
Lu	1kg	\$10.34	\$5.73	\$4.61
Yams-early	1kg	\$8.90	\$4.56	\$4.34
Tuna	1kg	\$21.00	\$17.00	\$4.00
Imported				
Turkey tails	1kg	\$14.08	\$10.88	\$3.20
Petrol	litre	\$3.22	\$2.62	\$0.60
Diesel	litre	\$3.16	\$2.62	\$0.54

Source: Statistics Department

contributed by domestic prices. Higher local prices are largely attributed to the rise in prices of food items and tobacco. Rising imported fuel and food prices contributed to the increase in import prices over the month, reflecting the soaring global oil and food prices.

The annual headline inflation significantly rose over the year by 9.1%, attributed to higher domestic and imported prices.



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Increased domestic prices stemmed from the higher prices of food items, electricity, and tobacco. On the other hand, the rise in imported inflation was driven by higher prices of fuel, food items, construction materials, and liquefied petroleum gas. The rise in energy prices also passes through to domestic production prices further compounding price pressures.

AUD, NZD, and FJD appreciated against the TOP

Table 3: Effective Exchange Rates

	Monthly			Annual	
	Feb-22	Jan-22	% Growth	Feb-21	% Growth
Nominal Effective Exchange Rate Index	90.4	90.7	-0.4	85.6	5.6
Real Effective Exchange Rate Index	110.9	109.2	1.5	100.8	10.0

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) fell slightly over the month reflecting the general appreciation of the AUD, NZD, and FJD against the TOP. The Real Effective Exchange Rate (REER) index increased over the month in line with the higher inflation rate.

In year ended terms, the NEER increased as trading partners' currencies weakened against the Tongan Pa'anga, partially neutralising some of the imported inflation. The REER also increased over the year in line with Tonga's higher inflation rate compared to our trading partner countries. This also indicates a loss in trade competitiveness.

Higher foreign receipts for HTHH and remittances

Table 4: Foreign Reserves

	Monthly			Annual	
	Feb-22	Jan-22	%Growth	Feb-21	% Growth
Foreign Reserves (\$ in million)	867.3	856.1	1.3	692.4	25.3
Import Coverage (months)	13.4	13.2	0.8	13.3	0.5

Source: National Reserve Bank Tonga

Foreign reserves increased in February 2022 by \$11.1 million to a new record high of \$867.3 million, equivalent to 13.4 months of imports. This was attributed mostly to net sales from commercial banks owing to receipts of remittances and relief funds from development partners. In year ended terms, foreign reserves still increased significantly by \$174.9 million, on the back of 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		
	Feb-22	Jan-22	% Growth	Feb-22	Feb-21	% Growth
Remittance (\$ in million)	27.7	29.1	-4.7	489.6	411.3	19.0

Source: National Reserve Bank Tonga

Remittance receipts declined over the month by \$1.4 million (4.7%) due mainly to the fall in private transfer receipts and compensation of employees. This largely reflects the disruptions in financial services from the internet outage and national lockdown. However, remittances continued to rise over the year, increasing by \$78.3 million (19.0%). This

stemmed from higher private transfers, compensation of employees, and private capital transfers.

Table 6: Overseas Exchange Transactions

	Monthly			Annual		
	Feb-22	Jan-22	% Growth	Feb-22	Feb-21	% Growth
Overall Balance	11.1	38.6	-71.1	174.9	212.5	-17.7
Current Account	4.0	46.8	-91.4	121.1	168.2	-28.0
Merchandise Trade	-25.3	-29.1	13.1	-476.8	-421.8	-13.0
Services	-3.0	-2.5	-21.8	-44.6	-17.0	-162.8
Income	2.4	2.9	-16.1	27.5	23.5	16.8
Transfers	29.9	75.5	-60.4	615.0	583.4	5.4
Capital Account	0.2	0.5	-57.7	16.5	44.2	-62.8
Financial Account	6.9	-8.7	179.2	37.3	0.1	30958.8

Source: Banking Systems

The overall balance surplus was lower in February underpinned by the drop in the current account surplus, following the hike in official transfer receipts in January. In the year to February 2022, the OET balance surplus declined by \$37.7 million which was largely contributed by the widening trade deficit and net service outflows partially offsetting the higher surplus in transfers.

Broad money expanded

Table 7: Broad Money

	Monthly			Annual	
	Feb-22	Jan-22	% Growth	Feb-21	% Growth
Broad money (\$ in million)	851.2	832.8	2.2	703.4	21.0
Net Foreign Asset	855.2	844.4	1.3	722.0	18.4
Net Domestic Asset	-3.0	-10.7	71.9	-17.6	83.0

Source: Banking System, National Reserve Bank of Tonga

Broad money grew over the month by \$18.5 million (2.2%) and over the year by \$148.8 million (21.0%). Net foreign assets increased corresponding to the rising foreign reserves, whilst the lower government deposits led to the monthly rise in net domestic assets. Annually, the higher capital and other assets account contributed to the increase in net domestic assets.

Significant increase in liquidity

	Monthly			Annual	
	Feb-22	Jan-22	% Growth	Feb-21	% Growth
Reserve money (\$ in million)	600.7	576.6	4.2	421.2	42.6

Source: Banking System, National Reserve Bank of Tonga

Liquidity or Reserve Money in the financial system expanded over the month and year to February 2022, by \$24.1 million (4.2%) and \$179.5 million (42.6%) respectively. This was led by the significant rise in Exchange Settlement Accounts by \$13.6 million (3.7%) over the month, and \$132.9 million (53.3%) over the year, owing largely to net sales of foreign currency from the commercial banks to the Reserve Bank from remittance receipts. Currency in circulation also rose markedly over the month and year by \$10.3 million (7.9%) and \$34.3 million (32.4%) respectively, reflecting the higher demand for cash for the Covid-19 national lockdown purchases and annual domestic festivities. Statutory Reserve Deposits also rose by \$0.2 million (0.3%) and \$12.3 million (18.7%) over the month and year respectively, in line with the movements in deposits.

Credit growth declined, while deposits expand



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Table 9: Total Lending

Lending	Monthly			Annual	
	Feb-22	Jan-22	% Growth	Feb-21	% Growth
Total Lending (\$ in million)	472.5	473.9	-0.3	492.2	-4.0
Business lending	216.1	216.0	0.1	234.0	-7.7
Household lending	254.6	256.3	-0.7	258.2	-1.4
Other lending	1.8	1.7	6.7	0.0	0.0

Source: Banking System, National Reserve Bank of Tonga

Over the month and year to February 2022, the banks' total lending fell by \$1.4 million (0.3%) and \$19.7 million (4.0%) respectively. Lending to households declined over the month and outweighed the slight rise in business loans. Lending to businesses in the professional & other services, tourism, and transport sectors rose over the month. Annually, both business and household loans declined, attributed to lower public enterprises loans and lending to businesses within the professional & other services, construction, and agriculture sectors as well as all categories of household loans.

Total deposits, however, continued to rise strongly by \$16.5 million (2.0%) over the month and \$145.5 million (20.7%) over the year to a total of \$848.6 million. This reflects higher deposits from the Government, retirement funds, and the private sector. Coupled with the declining loan balances, the loans to deposit ratio fell again from 55.7% in January 2022 and 68.2% in February of last year, to 54.5% in February 2022, remaining below the 80% minimum threshold.

The weighted average interest rate spread widened

Table 10: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Feb-22	Jan-22	(bps)	Feb-21	(bps)
Weighted Average Banks Deposit Rate (%)	1.695	1.710	-1.5	2.002	-30.6
Weighted Average Banks Lending Rate (%)	7.835	7.840	-0.44	7.694	14.1
Weighted Average Interest Rate Spread (%)	6.140	6.130	1.0	5.693	44.7

Source: Banking System, National Reserve Bank of Tonga

Over the month and year to February 2022, the weighted average interest rate spread widened to 6.14%. The monthly rise was due to weighted average deposit rate falling more than the decline in the weighted average lending rate. All the three categories of deposit rates generally fell over the month. The time deposits' rates offered primarily for a term of 3 months, 1 month and 2 years declined over the month. Similarly, the lending rates offered to businesses within the tourism, fisheries and

professional & other service sectors fell over the month, along with the household vehicle loan rates.

Annually, the weighted average deposit rate decreased and offset the rise in the weighted average lending rate. All the categories of deposit rates declined, led by time deposit rates, and followed by savings and demand deposit rates. On the other hand, the rising lending rates stemmed mostly from higher rates offered to non-profit organizations, businesses in the utilities, construction, and distribution sectors, as well as households' housing and vehicle loans.

Outlook

The Tongan economy has suffered multiple disasters including the HTHH volcanic eruption and the Omicron outbreak. At the same time, it is also facing extraordinary challenges of global supply chain disruptions and elevated inflation. The Reserve Bank expects these events to further derail economic recovery for the current fiscal year. Inflation is anticipated to remain above the 5% reference until 2023. Foreign reserves will continue to increase and stay well above the minimum of 3 months of import cover due to the expected inflow of budget support, relief funds, aid, grants, and private remittances in response to the HTHH disaster. The stringent Covid restrictions continue to impact businesses' operations, employment, and income. While non-performing loans are expected to rise, the financial system is well capitalised to absorb any shock to the system.

In light of the above developments and outlook, the Reserve Bank acknowledges that the country is facing extraordinary challenges, as such the current accommodative stance will still be on hold to support recovery. This also aligns with the Government's fiscal policies. 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 therefore adopts a wait-and-see approach on these actions to take effect and will stand ready to adjust its monetary policy should inflation continue to increase unsustainably.