



### Global prospects deteriorate with difficult policy trade-offs

The International Monetary Fund (IMF) in its April 2022 World Economic Outlook (WEO) reported global economic growth to be slower than previously estimated, while inflation becomes more persistent than previously envisaged. Global economic growth is now anticipated to slow down from 4.4% in 2022 and 3.8% in 2023 to 3.6% respectively, reflecting setbacks from the war in Ukraine, the sanctions on Russia, and the lockdowns in China. Inflationary pressure, on the other hand, is accelerating prompting more aggressive tightening from central banks. In the first quarter of 2022, the US Bureau of Economic Analysis reported a 1.4% decline in real GDP growth. The annual inflation rate also reached a 41-year high of 8.4% in March 2022, attributed to elevated energy and food prices. At the same time, the Federal Reserve started lifting interest rates for the first time since 2018 by 0.25 basis points to a target range of 0.25% to 0.5% and anticipates further interest rate hikes to curb inflation. The Australian Bureau of Statistics also recorded a 5.1% annual inflation rate for the March 2022 quarter, attributed to high prices of new dwellings and automotive fuels. Higher new dwellings indicate the ongoing supply disruptions, labour shortages, and strong rebound in demand. At the same time, Statistics New Zealand reported a 30-year high inflation rate of 6.9% for the March 2022 quarter, with housing costs, petrol, and food prices as the key drivers. Wage inflation also rose by 3.0% in the March 2022 quarter, the highest rise in more than a decade.

### Domestic performance remains weak as Covid-19 outbreak continues

After easing lockdown restrictions from late February to March, allowing most of the wholesale and retail distribution businesses to operate, the positive Covid-19 cases spiked again prompting another hard lockdown from 21<sup>st</sup> March until April. In recognition of the significant challenges caused by these disruptions while the country is trying to recover from the HTHH disaster, the Government announced an extension of its fiscal stimulus package to assist businesses and households during these difficult times.

The primary sector performance continues to reflect the impact of the severe damages from the HTHH disaster in March 2022. Agricultural export volume fell over the month by 15.4 tonnes (5.7%), mostly from lower exports of cassava by 19.3 tonnes (21.1%) and fruit products-plantains by 15.2 tonnes (66.4%), and is still significantly below the monthly average levels. This coincides with the \$0.2 million (29.9%) decline in agricultural proceeds. Similarly, agricultural export volume declined over the year by 861.3 tonnes (8.1%), driven by lower yams (1,114.2 tonnes) and taro (572.0 tonnes) exports. Marine export volume rose again over the month by 24.7 tonnes (49.5%)

driven by higher exports of tuna (53.9 tonnes). Aquarium export volume also rose significantly by 6,302 pieces (441.3%) driven by higher exports of live fish, invertebrates, and live hard coral. This is in line with the \$0.1 million (156.1%) increase in the marine export proceeds recorded during the month. The gradual monthly increases in the fisheries sector indicate more resilience to the HTHH disaster compared to the agriculture sector, however, it only accounts for around 2.0% of Tonga's GDP. Over the year, both exports of marine and aquarium products rose again by 98.7 tonnes (7.8%) and 5,260 pieces (4.2%), respectively.

The activities in the industrial sector continued to be hampered by the extended Covid-19 lockdowns and restrictions. Although there is a recorded 36.0% increase in electricity consumption in March it is not indicative of the pace of economic activities, but rather an increase in household consumption during the lockdown periods. The Government has also expedited the HTHH reconstruction works, starting with a few of the houses that were completely destroyed in Patangata and Sopus. This coincides with the increase in business registrations of new construction businesses to cater to the Government's reconstruction projects. These projects will positively contribute to the construction sector, with spillover effects to quarrying and manufacturing, supporting a moderate economic recovery in the short to medium term.

The tertiary sector struggles to adapt to the restrictive Covid-19 environment. Essential services including financial services have made adjustments to their operations to comply with the Covid-19 requirements and continue to serve the public. Many workplaces have adopted hybrid virtual work-from-home policies and bubbles to ensure business continuity and employment. Non-essential services must meet the safety requirements of the Ministry of Health before being granted a permit to operate. Most of the education sector, however, was still closed along with gyms, dining in restaurants, entertainment, and churches to name a few. Container registrations rose again in March 2022 primarily due to a 92.6% (286 containers) increase in private containers. These are mostly humanitarian support and in-kind remittances from families and relatives abroad. Meanwhile, business containers decreased by 34.4% (199 containers). More passenger arrivals were recorded in March with the continuation of the repatriation flights and revisions to the quarantine requirements allowing for home isolation. As a result travel receipts increased by \$0.7 million (75.2%). On the other hand, more seasonal workers continue to depart for Australia and New Zealand which will support remittance flows over the coming months.

### Increasing job demand

The Reserve Bank resumed its job surveys in March 2022 as internet connections normalised. The survey recorded a significant increase in job vacancies compared to normal monthly averages. The majority of the job vacancies advertised were from public administration. Annually, job



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vacancies rose by 228 vacancies (116.9%) reflecting higher demand for employment.

### Inflation eased in March

Inflation slightly rose over the month by 0.2%, owing mostly to higher prices of fuel and food items. Domestic prices, however, declined and partially offset the rising import prices as local food prices for vegetables and root crops declined.

Prices	Monthly		Annual	
	Mar-22	Feb-22	Mar-22	Mar-21
Headline Inflation (%)	0.2	2.0	7.8	3.3
Domestic prices	-1.2	3.7	6.9	1.6
Imported prices	1.4	0.6	8.6	4.7

Source: Tonga Statistics Department

The annual headline inflation was reported at 7.8% in March, lower than the 9.1% in February but still above the 5% reference rate. Both domestic and imported prices increased over the year. Import prices rose by 8.6% owing to significant increases in fuel, imported food items, construction materials, and petroleum gas. This is reflective of the rising commodity prices globally. Domestic prices also rose by 6.9% mostly from increases in local food prices and electricity. Natural disaster shocks have impacted the domestic food supply, while higher fuel prices pass-through to domestic energy prices.

Items (\$ per kg)	Unit	Annual Change		
		Mar-22	Mar-21	Mar-21
<b>Domestic</b>				
Tuna	1kg	\$21.00	\$17.00	\$4.00
Tomatoes	1kg	\$23.24	\$20.28	\$2.96
Lu	1kg	\$8.52	\$5.57	\$2.95
Capsicum	1kg	\$17.02	\$14.48	\$2.54
<b>Imported</b>				
Turkey tails	1kg	\$14.08	\$10.88	\$3.20
Petrol	litre	\$3.43	\$2.75	\$0.68
Diesel	litre	\$3.38	\$2.73	\$0.65

Source: Statistics Department

This inflationary pressure highlights Tonga's vulnerability to natural disasters and external shocks as an import-dependent economy. Disruptions to global supply chains and soaring freight rates will continue to push oil, food, and commodity prices higher. This will have large implications on Tonga's inflation as around 35% of the Consumer price index is comprised of imported food and fuel. This does not yet account for the pass-through of imported inflation to domestic energy prices and producer prices.

### Effective exchange rates increased slightly

	Monthly			Annual	
	Mar-22	Feb-22	% Growth	Mar-21	% Growth
Nominal Effective Exchange Rate Index	90.6	90.4	0.3	87.9	3.1
Real Effective Exchange Rate Index	111.0	110.9	0.1	105.1	5.6

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) rose slightly over the month reflecting the general weakening of the USD, JPY, GBP, EUR, and CNY against the TOP. The Real Effective Exchange Rate (REER) index increased over the month in line with the higher inflation rate.

Annually, the NEER still increased as trading partners' currencies weakened against the Tongan Pa'anga. The

REER increased also over the year in line with the higher inflation rate.

### Foreign exchange payments reduced foreign reserves

	Monthly			Annual	
	Mar-22	Feb-22	% Growth	Mar-21	% Growth
Foreign Reserves (\$ in million)	861.4	867.3	-0.7	685.7	25.6
Import Coverage (months)	13.2	13.4	-1.5	12.5	5.6

Source: National Reserve Bank Tonga

Foreign reserves declined in March 2022 by \$5.8 million to \$861.4 million, equivalent to 13.2 months of imports. This stemmed from an increase in transfers for large import payments and external loan repayments. In the year to March 2022, foreign reserves continued to increase significantly by \$175.8 million, attributed to 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.

	Monthly			Annual		
	Mar-22	Feb-22	% Growth	Mar-22	Mar-21	% Growth
Remittance (\$ in million)	32.0	27.7	15.6	478.1	428.7	11.5

Source: National Reserve Bank Tonga

Total remittance receipts increased by \$4.3 million (15.6%) to \$32.0 million in March 2022. This was mainly driven by higher private transfer receipts, mostly in USD, NZD, and AUD. The improvement in internet connection and the gradual easing of Covid-19 restrictions have allowed for more financial services during the month. Annually, remittances continued to increase by \$49.4 million (11.5%) in March 2022. This stemmed from higher private transfers, compensation of employees followed by private capital transfers.

	Monthly			Annual		
	Mar-22	Feb-22	% Growth	Mar-22	Mar-21	% Growth
Overall Balance	-5.8	11.1	-152.3	175.8	228.2	-23.0
Current Account	7.7	4.0	92.3	136.0	164.4	-17.3
Merchandise Trade	-34.4	-25.3	-36.3	-465.3	-435.2	-6.9
Services	-6.4	-3.0	-113.8	-48.3	-20.4	-137.3
Income	0.9	2.4	-61.7	25.8	27.0	-4.7
Transfers	47.6	29.9	59.6	623.9	592.9	5.2
Capital Account	1.3	0.2	482.3	16.9	43.0	-60.7
Financial Account	-14.8	6.9	-314.9	22.9	20.8	9.7

Source: Banking Systems

The Overseas Exchange Transactions (OET) recorded an overall balance deficit of \$5.8 million in March 2022 compared to the \$11.1 million surplus in February 2022. This stemmed from a decline in the financial account, underpinned by the increasing foreign exchange outflows.

In the year to March 2022, the OET balance surplus declined by \$52.4 million to \$175.8 million in March 2022. This was mainly underpinned by lower surpluses in the current and capital account. These are mainly from higher payments for imports and services, and lower official transfer and capital receipts.



### Broad money declined

Table 7: Broad Money

	Monthly			Annual	
	Mar-22	Feb-22	% Growth	Mar-21	% Growth
Broad money (\$ in million)	844.9	851.2	-0.7	707.6	19.4
Net Foreign Asset	852.8	855.2	-0.3	717.6	18.8
Net Domestic Asset	-7.0	-3.0	-133.5	-9.2	23.5

Source: Banking System, National Reserve Bank of Tonga

Broad money declined over the month of March 2022, by \$6.3 million (0.7%), however, rose annually by \$137.3 million (19.4%). The lower net domestic assets were driven mostly by lower credit to private sectors and net credit to non-financial corporations. Similarly, net foreign assets fell in line with the decline in the foreign reserves.

Over the year, the net foreign assets rose significantly corresponding to the rising foreign reserves. The net domestic assets also improved supported by the higher capital and other assets.

### Liquidity in the financial system decreased

Table 8: Reserve money

	Monthly			Annual	
	Mar-22	Feb-22	% Growth	Mar-21	% Growth
Reserve money (\$ in million)	598.0	600.7	-0.4	425.8	40.4

Source: Banking System, National Reserve Bank of Tonga

Liquidity in the financial system marginally declined in March 2022 by \$2.6 million (0.4%) but increased annually by \$172.2 million (40.4%). The Exchange Settlement Accounts (ESA) fell over the month underpinned by banks' net purchases of foreign currency and net withdrawals from the Reserve Bank vault, which more than offset the increase in both currency in circulation and statutory reserve deposits (SRD).

Annually, liquidity continued to increase on the back of rising ESA from high foreign currency receipts. This was supported by the rise in currency in circulation indicating higher demand for money, and the increase in SRD reflecting the growth in deposits.

### Credit growth further declined

Table 9: Total Lending

Lending	Monthly			Annual	
	Mar-22	Feb-22	% Growth	Mar-21	% Growth
Total Lending (\$ in million)	468.1	472.5	-0.9	488.8	-4.3
Business lending	213.4	216.1	-1.3	230.3	-7.3
Household lending	252.9	254.6	-0.7	258.1	-2.0
Other lending	1.8	1.8	0.3	0.5	274.4

Source: Banking System, National Reserve Bank of Tonga

The banks' total lending decreased again in March 2022, by \$4.4 million (0.9%) over the month, and \$20.8 million (4.3%) annually. Both business and household loans declined, reflecting large loan repayments mostly from public enterprises, and businesses within the construction, tourism, and forestry sectors. Domestic and global shocks to the economy, the high degree of uncertainties, and overall downside risks continue to dampen credit growth.

Total deposits declined also over the month by \$9.5 million (1.1%), however, continued to rise strongly over the year by \$130.5 million (18.4%) to a total of \$839.1 million. The monthly decline in deposits outweighed the decline in lending, resulting in a slight improvement in the loans to

deposit ratio to 54.6% from 54.5% last month. Annually, the rising deposit volumes coupled with the declining lending pushed the loans to deposit ratio lower from the 67.2% recorded last year, and remaining below the 80% minimum threshold.

### Weighted average interest rate spread narrowed

Table 10: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Mar-22	Feb-22	(bps)	Mar-21	(bps)
Weighted Average Banks Deposit Rate (%)	1.705	1.695	0.9	2.007	-30.2
Weighted Average Banks Lending Rate (%)	7.829	7.835	-0.7	7.687	14.1
Weighted Average Interest Rate Spread (%)	6.124	6.140	-1.6	5.680	44.4

Source: Banking System, National Reserve Bank of Tonga

In March 2022, the weighted average interest rate spread narrowed over the month, however, widened annually to 6.12%. The monthly decline is attributed to the higher weighted average deposit rate, coupled with the lower weighted average lending rate. Both the time and the demand deposit rates increased over the month and outweighed the decline in saving deposit rates. On the other hand, the lending rates offered to businesses within the construction, wholesale and retail, and tourism sectors declined over the month, along with the household other personal loan rates.

Annually, the declining weighted average deposit rate coupled with the rise in the weighted average lending rate continued to widen the interest rate spread. Deposit rates fell, led by time deposit rates, followed by savings and demand deposit rates. The higher weighted average lending rate were mostly from business lending rates such as the loan rates for utilities, construction, and manufacturing sectors. Lending rates for housing and vehicle loans also rose over the year.

### Outlook

Uncertainties on the duration of the Covid-19 outbreak will continue to restrict 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 provisions to absorb any shocks to the system.

The Reserve Bank recognises that the trade-off between supporting economic recovery and countering inflation requires delicate balancing actions. As such, 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.